United States Court of Appeals

for the Second Circuit

APPENDIX

76-4067

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 76-4067

ARTHUR LIPPER CORPORATION AND
ARTHUR LIPPER, III,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

B

P/S

On Petition for Review of Orders of the
Securities and Exchange Commission

JOINT APPENDIX

Howard Sanford Klotz
405 Lexington Avenue
New York, New York 10017

John A. Dudley
Sullivan & Worcester
1025 Connecticut Avenue
Washington, D.C. 20036

Attorneys for Petitioners

Harvey L. Pitt
Paul Gonson
Alan Rosenblat
Daniel L. Goelzer
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Attorneys for Respondent

VOLUME II

PAGINATION AS IN ORIGINAL COPY

TABLE OF CONTENTS

Item	Page
	Volume I
Certified List of All Documents, Transcripts, Exhibits and Other Material Comprising the Record in the Matter of Arthur Lipper Corporation, et al. 1/	1-32
Document No. 1 2/ — Official transcripts of proceedings before Chief Hearing Examiner Warren E. Blair; etc.:	
Excerpts from the testimony of Norman Carney	33-34
Excerpts from the testimony of Richard Roberts	35-36
Excerpts from the testimony of Edward M. Cowett	37-141
Excerpts from the testimony of Gilbert W. Smith	142-144
Excerpts from the testimony of Arthur Lipper, III	145-229
Excerpts from the testimony of Nancy L. Stuart	230-234
Full testimony of Allan F. Conwill	235-318

1/ This listing is included in lieu of a listing of the relevant docket entries as required by Rule 30(d) of the Federal Rules of Appellate Procedure.

2/ Items in this appendix are identified by the corresponding document number as shown in the certified listing appearing at pages 1-32.

Full testimony of Robert M. Bishop 319-334

Volume II

Document No. 3 — Grant Exhibit A — Letter from Grandefeld & Goodman by John J. Grandefeld to Mr. Norman Carney, Hertz, Neumark & Warner, dated January 25, 1967 335

Document No. 4 — Grant Exhibit B — Letter from Grandefeld & Goodman by John J. Grandefeld to Mr. Norman Carney, Hertz, Neumark & Warner, dated February 10, 1967 336

Document No. 19 — IOS Exhibit C — Document captioned "A Periodic Report to the Exchange Community from G. Keith Funston," dated July 21, 1967 337-340

Document No. 26 — IOS Exhibit I — Letter from Robert W. Haack to Members and Allied Members, Re: Proposed Amendment to Article XV, dated October 10, 1968 (pages 1-3 only) 341-343

Document No. 28 — IOS Exhibit L — Letter from Robert W. Haack to Members and Allied Members, Re: Commissions-Reciprocal Arrangements, dated November 22, 1968 (with attachment) 344-347

Document No. 134 — Division's Exhibit 36 — Order for public proceedings, etc. in the Matter of IOS Ltd. (S.A.), etc., et al., dated February 3, 1966 .348-367

Document No. 135 — Division's Exhibit 37 — Order accepting offer of settlement in the Matter of IOS Ltd. (S.A.), etc., et al., dated May 23, 1967 [Securities Exchange Act Release No. 8083] 368-377

Document No. 145 — Division's Exhibit 47 — Letter from Irving M. Pollack, Director, Division of Trading and Markets, to the presidents of the various national securities exchanges and the NASD, dated July 18, 1966 [attestation omitted] 378-382

Document No. 194 — Division's Exhibit 78 — Document captioned "Across the President's Desk, A Periodic Report to the Exchange Community from G. Keith Funston," dated February 1, 1967 383-397

Document No. 286 — Initial Decision of Hearing Examiner [as to Lipper respondents], dated June 11, 1971 398-423

Document No. 358 — Securities Exchange Act Release No. 11773 (October 24, 1975) [Order and opinion of the Commission in the Matter of Arthur Lipper, III, IOS Ltd. (S.A.), and Investors Planning Corporation of America]. 424-455

Document No. 364 — Securities Exchange Act Release No. 11980 (January 6, 1976) [Memorandum opinion and order denying petition for rehearing] 456-458

1 47

1

EXHIBIT IV(a)

GRANDEFELD & GOODMAN
COUNSELLORS AT LAW
15 WILLIAM STREET
NEW YORK 5. N. Y.

HANOVER 2-0046

January 25, 1967

Hertz, Neumark & Warner
No. 2 B roadway
New York, New York 10004

Attention: Mr. Norman F. Carney

Gentlemen:

This is to advise you that I have checked the question of a member firm of the New York Stock Exchange splitting over-the-counter comm sions with an over-the-counter house, which is not a m ber firm of the Exchange, with the Department of Member Firms of the New York Stock Exchange.

I have been advised that there is no present rule against this type of split in commissions as long as both firms are members of the NASD.

I have checked the Directory and Guide of the New York Stock Exchange and I have been unable to find any rule against splitting commissions of this type. I have also spoken to Mr. Schaffler of the Department of Member Firms of the New York Stock Exchange, and he advised that there is no restriction against the same.

However, in connection with this advice, it is vitally important that you observe the fact that no commission arising out of a listed security can be shared in any way with a non-member firm. It is vitally important that you carefully check the securities out of which the commissions arise, to be sure that at no time will your firm distribute any part of the commissions arising out of a listed transaction with anyone other than a member, member firm, or member corporation of the New York Stock Exchange.

Very truly yours,

GRANDEFELD & GOODMAN

By: J. J. Grandefeld
JOHN J. GRANDEFELD

JJG:jo

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Hertz

XHIBIT IV(b)

GRANDEFELD & GOODMAN
COUNSELLORS AT LAW
15 WILLIAM STREET
NEW YORK 5, N. Y.

HANOVER 2-0045

(9)

1348

February 10, 1967

Mr. Norman Carney
Hertz, Neumark & Warner
2 Broadway
New York, N. Y.

Dear Norman:

As per your request of February 8th, I wish to advise you that it is the intention of my letter of January 25, 1967 to include the right of your firm to split commissions in Over-the-Counter stocks with other NASD member firms. You will note that in my letter of January 25th, I refer to the fact that there is no present rule against splitting commissions in Over-the-Counter stocks, as long as both firms are members of the NASD.

I trust that this letter will broaden my previous opinion sufficiently to meet your needs in this matter.

If I can be of further assistance to you in any way please do not hesitate to communicate with me.

Very truly yours,

GRANDEFELD & GOODMAN

By: JOHN J. GRANDEFELD

JJG/e

Grant x B ford 8-15-20 P.P.

336

BEST COPY AVAILABLE

A Periodic Report to the Exchange Community
from G. Keith Funston

July 21, 1967
Issue #16

I last reported to you on May 4 about the work of the Special Committee on Member Firm Costs and Revenues. Since that time the Committee has been studying some basic facts about the relationships between the Exchange community and its customers. Several problem areas have been identified which are related to the present commission structure, and which a different commission structure might make more tolerable.

The first problem area is the relationship between different sized trades and the commissions they produce. The table below, based on trades reported in the 1966 Public Transaction Study, highlights the important facts.

	Trades			Commissions		
Size of Trade	Odd Lot	Round Lot	Total	Odd Lot	Round Lot	Total
$ 0 - 2,500	35%	13%	48%	9%	6%	15%
2,500 - 5,000	5	21	26	3	15	18
5,000 - 25,000	1	22	23	1	33	34
25,000 - 100,000	-	3	3	-	18	18
100,000 +	-	-	-	-	15	15
	41%	59%	100%	13%	87%	100%

The table shows that almost half (48%) of the trades handled by member firms on the PTS day were for less than $2,500, and these produced only 15% of the commission income. At the other end of the scale, less than one percent of the trades were for more than $100,000 - and these, too, produced 15% of commission income.

Generally speaking, the smaller trades are handled for individual customers of limited means. Often these are the very persons most in need of time consuming securities advice and financial counseling. Yet these trades produce a disproportionately small amount of commissions. The result is that frequently securities service is extended to these persons at a loss. Most of them would want to pay their own way for the level of service they need.

Individual firms whose mix of business is typical of the industry can adjust for losses on small trades by use of income from large trades within their own firm. But the firms which handle mostly small accounts cannot compensate this way. The Committee feels it would be fairer to them and better for their customers if small trade commissions were brought more nearly into line with small trade costs.

Another problem is the wide disparity in commission rates between low priced and high priced stocks. The table below shows the dollar amounts and percentage rates of commissions on $25,000 invested in stocks at $5, $50, and $250.

Price of Stock	Commission	% of Value
$ 5	$600	2.40%
50	220	.87
250	64	.26

The commission on the $5 stock is almost ten times the commission on the $250 stock. This has the effect of favoring the customer who buys high priced stock over the customer who buys low priced stock.

Orders for multiple lots of low priced shares may be more costly to handle than orders for single lots of high priced shares, but the difference in commissions is out of line with the difference in costs. The Committee feels it would be better if these commission differences were made smaller.

The third problem area has to do with the type of business being done today on the Exchange. In 1947, when the present commission structure was adopted, most trades were for 100 shares, and it made sense for commissions to be based on the money involved in a single round lot. The increase in institutional business since 1947 has brought an increase in block trades. Figures from 1947 are not available, but the change between 1961 and 1966 can be measured by the distribution of money value by round lot order size in the Public Transaction Studies in those two years, and it is impressive.

Public Transaction Study	100 Shares	200-1,000 Shares	Over 1,000 Shares
September 13, 1961	40%	49%	11%
October 14, 1966	31	43	26

The Committee believes the change in the nature of the business done on the Exchange would justify a change in the way commissions are calculated to better reflect the handling cost of block orders as compared to 100 and 200 share orders.

The fourth problem area is the effect on overall commission rates of the long standing trend of a rising average price of shares traded. The round lot based commission schedule, as we have seen, produces a higher rate for low priced stocks and a lower rate for high priced stocks. For many years we have been saying that public commissions are about 1% of the value of shares traded. But let's look at the actual average rates realized on trades reported in the last three Public Transaction Studies.

Public Transaction Study	Commissions as a percent of value of shares traded
October 16, 1963	.98%
March 10, 1965	.95
October 19, 1966	.89

Member firms have seen their average rate of commission decrease 9% in these three years because of the rise in the average price of shares traded. What's more, the rise from 1963 to 1966 is just part of a long term trend in average price of shares traded: from $21.30 in 1943 to $35.50 in 1958 and $44.70 in 1966. The Committee would like to see this gradual but substantial erosion in the rate of member firm commissions stopped.

The Committee has not found a ready made solution to these problems, but it is exploring a change in commission structure which might be better for customers and firms alike.

The change would be that the amount of commission would be largely governed by the dollar size of the order rather than the price of the stock. The final commission on a multiple round lot order would no longer be simply a multiple of the 100 share rate. Instead it would become proportionately lower as the total amount of money in the order grew.

The idea of an order based schedule is not new. It was suggested as early as 1953 by the predecessor to this Committee, and has been discussed from time to time in the years between. The reason the order based idea is being looked at in depth now is that circumstances have changed, so that an approach considered inappropriate 14 years ago may well be right on target today.

1675

An order based schedule could redistribute commission income so that member firms handling small orders would get a more equitable portion of total commissions. It could reduce or eliminate the wide disparities in commission rates arising from differences in share prices, and in the process decrease or eliminate the erosion in the rate of commission income as a result of a long term rise in the average price of shares traded. It could provide member firms and their customers with a method of computing commissions which would be more valid for the increasingly institutional markets of today and tomorrow. All these effects would be on the plus side of the ledger.

But no system is perfect, and the order based schedule has some features on the minus side of the ledger, too. For one thing, it would be a more complicated operations job of processing trades in both computerized and manual firms. Also, nonmember financial institutions might be able to group their customer orders to gain lower commission rates. Early indications are that orders would not be grouped much more than they are today, but further study of this question is needed.

Another complication which needs further study is that not only NYSE trades may be affected by a new schedule. Member firms have traditionally used the NYSE schedule to establish commissions on agency over-the-counter trades, and other Exchanges have followed similar schedules. An order based NYSE schedule should take into consideration the economic effect of possible use of the same structure in such other trades.

These difficulties are being carefully studied by the Committee to see how the problems may be minimized and whether, on balance, an order based schedule should be recommended. If the answer is yes, a new and extensive sample of orders will have to be taken to serve as a model for constructing and testing a specific schedule. The sample would be something like a Public Transaction Study, and would involve a lot of work by both the member firms and the Exchange.

Subjects scheduled for discussion in future papers are associate membership, nonmember discount and commissions between members. In this connection, I can't emphasize enough that while the Committee must consider these subjects one at a time, the final recommendations will be a package whose parts will be interdependent.

The Committee is interested in how the membership feels about its exploratory thinking on a different commission structure. Your comments on this interim report will be warmly welcomed.

Sincerely,

G. Keith Funston

SECURITIES AND EXCHANGE COMMISSION
Commission's EXHIBIT ___ of
Respondent's (Page ___
In the Matter of: IOS, Ltd.
-2157
Date 6-21-71 Witness Hunton Reporter SF

1709

SPECIAL MEMBERSHIP BULLETIN

NEW YORK STOCK EXCHANGE

ELEVEN WALL STREET

NEW YORK, N.Y. 10005

TO: All Members October 10, 1968

SUBJECT: Proposed Amendment of Article XV

At its policy meeting today the Board of Governors approved a proposed amendment to Article XV of the Constitution. The amendment provides a reduced rate for that portion of large orders over 1,000 shares, an across the board reduction in intra-member rates and a prohibition of customer directed give-ups. The text of the amended article is attached. The Securities and Exchange Commission has informed us that the amendment is acceptable and has called for an effective date of not later than December 5, 1968. At the same time the Commission pointed out that the alternative to the proposed amendment is negotiated commissions for orders over $50,000.

The amendment will help preserve the minimum commission by eliminating abuses which have developed with changing patterns of customer trading in recent years, and which have resulted in a leakage of the commission dollar. Customers with large orders are entitled to reduced rates because of the lower costs of processing those orders. Incorporating the reduced rates into the commission schedule will remove much of the pressure to get them circuitously, while prohibiting customer directed give-ups will remove the means for doing so. The reduction of intra-member rates will distribute the reductions in commission income throughout the membership.

A great deal of work and painstaking negotiation has gone into this amendment. Many variations and alternatives were discussed and tested. Our aim throughout was to produce an interim schedule which would be in the best interests of the public and the industry and in which the impact would be distributed among member firms as fairly as possible. We believe the resulting amendment, while by no means perfect, is the best which can be devised given the need for SEC approval.

The amendment is herewith submitted to the membership for balloting. Instructions for voting are printed on the enclosed Ballot. The Ballot should be delivered, in the envelope provided, to the Secretary of the Exchange by 3:30 p.m., October 24, 1968.

1720

BACKGROUND OF PROPOSAL

Initial Exchange Proposal

The submission of this amendment to the membership follows long and intensive negotiations with the Securities and Exchange Commission and its staff. The present phase of these negotiations began with our proposal to the SEC on January 2, 1968 of a five point package. The package was recommended to the Board by the Special Committee on Member Firm Costs and Revenues with the approval of its Regional Firms Advisory Group and the Association of Stock Exchange Firms. The five points were a volume discount, continuation of customer directed give-ups with a percentage limit, elimination of reciprocal practices in all markets which result in de facto rebates of NYSE commissions, a nonmember discount and SEC action to limit membership on all exchanges to bona fide broker dealers.

SEC Proposed Rule 10(b)10

The SEC did not directly respond to the Exchange's package proposal. Instead, on January 26 they published for comment a proposed Rule 10(b)10, which would prohibit give-ups of commission directed by investment companies (and perhaps by other fiduciaries as well) unless the full amount given up were credited or paid to the investment company.

Department of Justice Comments

The Department of Justice responded to the publication of proposed Rule 10(b)10 by sending its comments on April 1. The comments went beyond the proposed rule and questioned the necessity for minimum commissions in the securities business. It recommended that the SEC (1) hold hearings to determine the extent to which commission rate fixing by the Exchange is required by the purposes of the Securities Exchange Act of 1934, (2) eliminate all rate fixing found not to be in the public interest and (3) develop standards of reasonableness for any rate fixing permitted to continue. The Department of Justice also recommended that the SEC determine the proper means for assuring equitable and nondiscriminatory access by nonmember broker dealers to the NYSE market.

In response to the Department of Justice's comments, the SEC called for hearings to begin on July 1 to look into, among other things, reciprocal arrangements and give-ups, the necessity for minimum commissions, institutional membership and access by nonmember broker dealers. At the same time, in a letter dated May 28, the SEC requested pursuant to Section 19(b) of the Securities Exchange Act that on or before September 15 the Exchange modify its commission rate structure

either a) in accordance with a revised commission schedule attached to the letter (and described below), or alternatively, b) by eliminating minimum rates of commission on orders over $50,000. The SEC also asked that appropriate reductions be made in intra-member rates. The SEC stated that these changes were intended as an interim step until the Commission had determined, after the hearings were completed, what would be the optimum form of rate structure or whether there should be any schedule of specified rates.

Second Exchange Proposal

On June 27 the Board of Governors approved in principle a volume discount in the nonmember commission schedule and an appropriate corresponding reduction of intra-member rates, a step by step elimination of customer directed give-ups over a period of at least one year and a one third discount to qualified nonmember broker dealers after a legal problem posed by Section 3(a)(3) of the Securities Exchange Act had been resolved. Like the earlier package proposal, this one was recommended by the Costs and Revenues Committee after consulting with its Regional Group and the ASEF. The Board's action was publicized in a letter addressed to the SEC and also sent to the membership on the same day.

Following its earlier approval in principle, on August 8 the Board approved the details of the Exchange's proposal to the SEC. That proposal is the amendment which is now before the membership for a vote. On August 30, having solicited and received comments from other exchanges, the NASD and industry associations, the SEC informed the Exchange that it would modify alternative (a) of its May 28 request to conform to our proposal, leaving alternative (b), elimination of minimum commissions on orders over $50,000, unchanged. On September 4, the SEC further modified their original request to change the effective date from September 15 to not later than December 5, 1968.

On September 5 the Board of Governors, pursuant to Article XX of the Constitution and Rule 26, accepted and laid the proposed amendment on the table. Following today's action by the Board, the balloting period will run for two weeks, unless at the end of that time less than the majority of the members have voted, in which case the balloting will continue for an additional two weeks. If approved, the amendment will become effective on December 5.

EXPLANATION OF THE AMENDMENT

Nonmember Schedule

In its May 28 request, the SEC included as alternative (a) a commission schedule which would have provided a reduced rate of commission for that portion of an order exceeding 400 shares, with the life of the

SECURITIES AND ... Commission's Exhibit ... -2157 Respondent's (Page ___ of ___)

In re of: IOS, Ltd. ... 31-71 Witness: Hunton Reporter

1733

MEMBERSHIP BULLETIN

NEW YORK STOCK EXCHANGE

ELEVEN WALL STREET

NEW YORK, N.Y. 10005

ROBERT W. HAACK
PRESIDENT

November 22, 1968

TO: MEMBERS AND ALLIED MEMBERS

SUBJECT: COMMISSIONS—RECIPROCAL ARRANGEMENTS

As the effective date of December 5 approaches for the start of the new interim commission plan, instances are coming to light where some members and institutional customers seek to violate the spirit, if not the letter, of the ban on customer-directed give-ups by means of reciprocal and clearing arrangements.

It cannot be emphasized too strongly that the ban on give-ups was adopted as one means of strengthening and preserving the minimum commission structure, and that it must not be circumvented through misuse of traditional arrangements between members of this Exchange and the regional exchanges.

The issue at stake is no less than the future of the minimum commission structure.

In line with this concern, I attach a letter of November 21 to Chairman Cohen of the SEC making clear that the Exchange reserves the right to change the rules or interpretations governing reciprocal arrangements between its members and members of regional stock exchanges.

The Exchange has agreed with the SEC that the prohibition of customer-directed give-ups is not intended to abolish arrangements that have existed for many years between members of the NYSE and regional exchanges.

However, experience with the new interim commission schedule may require changes in the present interpretation of our rules affecting reciprocal relationships if it becomes apparent that the integrity of the minimum commission schedule is threatened.

In order to give the Exchange the information on which to base any action that may be required in this area, the Board of

Governors has approved in principle a rule requiring all members and member organizations to secure from the Exchange approval of any reciprocal or clearing arrangements relating to NYSE listed business. The proposed rule, subject to comment by the SEC, will require written reports of these arrangements, including the names of the participants, the dollar amount of business involved or contemplated, a description of the arrangement and the reasons for the arrangement.

Reports under the rule will not be required, of course, until after the rule is approved in its final form by the Board of Governors following discussion with the SEC. The membership will be notified in advance of the effective date.

In addition to aiding the Exchange in enforcement of its minimum commission rule, the proposed reports on reciprocal and clearing arrangements should also provide valuable data for the study the Exchange already has launched to develop detailed standards for a more permanent commission structure.

Robert W. Haack

NEW YORK STOCK EXCHANGE

ELEVEN WALL STREET

NEW YORK, N.Y. 10005

ROBERT W. HAACK
PRESIDENT

November 19, 1968

Mr. Manuel F. Cohen, Chairman
Securities and Exchange Commission
500 N. Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Cohen:

This is in reply to your letter of August 30, 1968 modifying the request contained in your letter of May 28, 1968.

The following language has been added to Article XV, Section 1 of the Exchange Constitution:

> "No member, member firm or member corporation shall, in consideration of the receipt of listed business and at the direct or indirect request of a non-member or by direct or indirect arrangement with a non-member, make any payment or give up any work or give up all or any part of any commission or other property to which such member, member firm or member corporation is or will be entitled."

In your letter you ask for confirmation that the additional language is intended to prohibit all forms of customer directed give-ups, but is not meant to preclude or interfere with non-customer directed interdealer reciprocal business on regional exchanges nor is it designed to prevent the procedures whereby broker-dealer affiliates of institutions may credit or return commissions to institutions with which they are affiliated. We assume that the word "interdealer" in your letter means "inter-broker" and that the procedures referred to for affiliates of institutions are those permissible under rules of regional exchanges but not of the New York Stock Exchange.

Under these assumptions, we agree with your understanding that the prohibition of customer directed give-ups is not intended to preclude or interfere with the inter-broker arrangements as they have existed for many years, whereby NYSE members have given their regional exchange business to regional-only members in reciprocity for NYSE business which the regional members have obtained casually

in the course of their other business.

However, the interim commission schedule which will become effective on December 5 is expected to bring about changes in trading patterns, particularly those of institutions, which are unforeseeable. For instance, it is beginning to appear that arrangements which today involve principally the above described traditional broker-to-broker reciprocity for listed NYSE business generated by members of regional stock exchanges may, after December 5, be used to subvert the intent of the give-up prohibition in the interim schedule, revive the give-up practices which it is designed to prohibit, and be a vehicle for circumventing the anti-rebate provisions of Article XV, Section 1 of the Exchange Constitution.

In view of these uncertainties, we must make clear that if future experience shows that these arrangements are being used to circumvent the give-up prohibition or the anti-rebate provisions of the Exchange Constitution, we may be required to change our interpretation to prevent sharing of commissions through a barely disguised give-up technique and to protect the integrity of the minimum commission, which we deem more important to the public interest than inter-broker reciprocity.

Very truly yours,

Robert W. Haack

1966 ADMINISTRATIVE PROCEEDING
FILE NO.: 3-497

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
February 3, 1966

In the Matter of I.O.S., LTD. (S.A.) d/b/a INVESTORS OVERSEAS SERVICES (8-8622) INVESTORS CONTINENTAL SERVICES, LTD. (8-6948) BERNARD CORNFELD EDWARD M. COWETT ALLEN R. CANTOR W. THAD LOVETT ROBERT NAGLER HYMAN FELD (Securities Exchange Act of 1934)	ORDER FOR PUBLIC PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 15A OF THE SECURITIES EXCHANGE ACT OF 1934

I

The Commission's public official files disclose and the Division of Trading and Markets alleges:

A. I.O.S., Ltd. (S.A.) d/b/a Investors Overseas Services (IOS), a Panama corporation, having its principal office at 119 rue de Lausanne, Geneva, Switzerland, became registered as a broker-dealer with the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act) on June 10, 1960.

B. Investors Continental Services, Ltd. (ICS), having its principal office at 7 West 57th Street, New York, New York, became registered as a broker-dealer with the Commission pursuant to Section 15(b) of the Exchange Act on November 18, 1958 and is a member of the National Association of Securities Dealers, Inc.

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348

C. IOS is the beneficial owner of more than 10% of the equity securities of ICS.

D. Bernard Cornfeld (Cornfeld) is the president, a director and beneficial owner of more than 10% of the equity securities of IOS and a director and indirect beneficial owner of more than 10% of the equity securities of ICS.

E. Edward M. Cowett (Cowett) is a vice-president and a director of IOS and secretary and a director of ICS.

F. Allen R. Cantor (Cantor) is senior vice-president of IOS.

G. W. Thad Lovett (Lovett) is executive vice-president of IOS.

H. Robert Nagler (Nagler) is a director of IOS.

I. Hyman Feld (Feld) is president and a director of ICS and an assistant-secretary of IOS.

J. Pursuant to Rule 17a-7 of the Exchange Act IOS filed on May 27, 1960 an undertaking signed by Cowett to furnish at its own expense to the Securities and Exchange Commission, at its principal office in Washington, D. C., "true, correct, current and complete copies of any part of the books and records which the undersigned is required to make, keep current or preserve pursuant to any provision of any rule or regulation of the Securities and Exchange Commission under the Exchange Act."

K. The Fund of Funds, Ltd., a non-resident Canadian corporation with its principal office at 119 rue de Lausanne, Geneva, Switzerland, is engaged in investing principally in shares of investment companies registered under the Investment Company Act of 1940 (Investment Company Act).

L. The IOS Investment Program for the accumulation of interests in The Fund of Funds, Ltd. is a front-end load installment payment plan, or a fully paid plan sponsored by IOS, by means of which interests in The Fund of Funds, Ltd. are offered for sale and sold.

M. No registration statement has been filed or is in effect with the Commission under the Securities Act of 1933 (Securities Act) with respect to the securities comprising interests in The Fund of Funds, Ltd. or with respect to the participations in the IOS Investment Programs.

N. Neither The Fund of Funds, Ltd. nor the IOS Investment Program relating thereto has filed an application pursuant to Section 7(d) of the Investment Company Act and neither has registered with the Commission pursuant to Section 8 of the Investment Company Act.

O. On May 28, 1965 Value Line Special Situations Fund, Inc. (Value Line) filed a prospectus in connection with post-effective amendment No. 22 to its registration statement pursuant to Sections 7 and 10 of the Securities Act and Rule 424(c) thereunder.

P. On May 20, 1965 Convertible Securities and Growth Stock Fund, Inc. (Convertible) filed a prospectus in connection with post-effective amendment No. 26 to its registration statement pursuant to Sections 7 and 10 of the Securities Act and Rule 424(c) thereunder.

Q. On September 20, 1965 Research Investing Corporation (RIC) filed post-effective amendment No. 15 to its registration statement pursuant to Sections 7 and 10 of the Securities Act.

R. On October 19, 1965 American Investors Fund, Inc. (American) filed a proxy statement pursuant to Section 14 of the Exchange Act.

S. Value Line, Convertible, RIC and American are investment companies registered pursuant to the provisions of the Investment Company Act.

II

The staff has obtained information which tends to show and the Division of Trading and Markets alleges:

A. VIOLATIONS OF SECTION 5 OF THE SECURITIES ACT AND VIOLATIONS OF SECTION 7 OF THE INVESTMENT COMPANY ACT

1. IOS is the underwriter and exclusive distributor of the IOS Investment Program for the accumulation of interests in The Fund of Funds, Ltd. (FOF) which includes interests in numerous other securities in the portfolio of FOF. In the offer and sale of the IOS Investment Program, IOS has used the United States mails and means and instrumentalities of interstate commerce.

2. No registration statement pursuant to Section 7 of the Securities Act with respect to interests in FOF or participations in the IOS Investment Program has been filed with the Commission and none has been declared effective. Accordingly, during the period from approximately September 1, 1962 to the present time, IOS, Cornfeld, Cowett, Cantor, Lovett and Nagler, singly and in concert, wilfully violated Sections 5(a) and 5(c) of the Securities Act in that said persons, directly and indirectly, made use of the means and instruments of transportation and communication in interstate commerce and of the mails to offer to sell, sell and deliver after sale securities, namely the IOS Investment Program for the accumulation of interests in FOF, when no registration statement was in effect as to said securities under the Securities Act.

1909

3. Neither FOF nor the IOS Investment Program relating thereto has filed an application pursuant to Section 7(d) of the Investment Company Act and neither has registered with the Commission pursuant to Section 8 of the Investment Company Act. Accordingly, during the period from approximately September 1, 1962 to the present time, IOS, Cornfeld, Cowett, Cantor, Lovett and Nagler, singly and in concert, wilfully violated and wilfully aided and abetted violations of Section 7(d) of the Investment Company Act in that said persons, directly and indirectly, made use of the means and instrumentalities of interstate commerce and of the mails to offer for sale, sell or deliver after sale in connection with a public offering of securities of investment companies (as defined in the Investment Company Act), namely FOF and the IOS Investment Program for the accumulation of interests in FOF, which companies are not and have not been organized or otherwise created under the laws of the United States or of a state.

4. Had such registration statements been filed and effective under the Securities Act and the Investment Company Act, full disclosure would have been required by the provisions of Sections 7 and 10 of the Securities Act and Sections 24 and 30 of the Investment Company Act, and the respective rules, regulations and forms thereunder, with respect to matters which have been inadequately and inaccurately disclosed as hereinafter stated; and such failure to register in that manner adversely affected the public interest and the interest of investors.

a. Quarterly reports of FOF to investors, under the heading "Highlights," include a table which compares the net asset value per share performance of FOF over stated periods of time with the performance of the "Mutual Fund Industry average," "Standard & Poor's '500' Stock Index" and "Dow-Jones Industrial Stock Average." The table omits to disclose to investors that while the FOF net asset value per share reflects the reinvestment of all net dividend and interest income and realized capital gains, the Standard & Poor's '500' Stock Index and the Dow-Jones Industrial Stock Average do not include any element of reinvestment of income. The Mutual Fund Industry average, to which comparison is also made, is not identified and the FOF reports do not state whether or not this average reflects such reinvestment. Nor do the FOF reports disclose that registered investment companies, with rare exceptions, distribute such dividends, income and realized gains to their shareholders. Contrary to items (h) and (q) of the Commission's Statement of Policy (17 CFR 271.2621), the table (i) omits to disclose material differences between the subjects of the comparison and (ii) compares the performance of FOF with that of a Mutual Fund Industry average without disclosing whether the companies whose shares are held in the portfolio of FOF constitute a group of companies which generally approximates in composition and character the group of companies whose shares are included in the Mutual Fund Industry average to which comparison is made.

351

b. The prospectus of FOF dated May 3, 1965, at page 5, the annual report of FOF to stockholders for the year ended December 31, 1964, at page 11, and the semi-annual report of FOF to stockholders for the six months ended June 30, 1965, at page 9, present charts which do not conform to item (j) of the Commission's Statement of Policy relating to the form and content of charts employed in the offer and sale of investment company securities.

c. The prospectus of FOF dated May 3, 1965 contains a "Statement of Net Assets." Note 1 to the financial statements contained therein states that as of December 31, 1964 there were 7,841,688 Class A non-voting shares and 350 common shares of FOF outstanding. Said note and prospectus omit to disclose that all of said 350 shares (the only outstanding voting shares) are controlled by IOS.

d. The prospectus of FOF dated April 1, 1964 and the prospectus of FOF dated May 3, 1965 each contain a section entitled "The Fund May Invest In" in which the various ways in which the assets of FOF may be invested are discussed. Neither prospectus discloses, however, that by reason of its control of all of the outstanding common (voting) stock of FOF, IOS may cause, and as set forth below has caused, the investment policy of FOF to be changed at will.

(i) The prospectus of FOF dated April 1, 1964 states that the Fund may invest in

(A) "Shares issued by any open-end investment company (mutual fund) registered with the United States Securities and Exchange Commission which primarily invests in U.S. securities. (The Securities and Exchange Commission is a permanent agency of the United States government which carefully regulates the securities industry in the U.S.) /Emphasis in original./

(B) "--Securities issued by any publicly-owned corporation in the United States principally engaged in the management and/or distribution of open-end investment companies.

(C) "--Obligations of the United States or Canadian governments, or cash and time deposit certificates issued by any bank or trust company having a net worth in excess of US $5,000,000. (Such investments are often intended for periods when unusual

1911

market conditions occur and Management considers that a defensive position is indicated. At such times, Management will emphasize conservation of principal and will maintain sufficient cash balances to permit the purchase of additional holdings at more favorable prices.)"

(ii) Without stating that the investment policy had been changed since April 1, 1964, and without identifying or explaining the reasons and purposes for, and the effects of, the changes, the prospectus of FOF dated May 3, 1965 states the investment policy of FOF as follows:

(A) "--Shares issued by any open-end or closed-end investment company registered with the United States Securities and Exchange Commission under the <u>Investment Company Act of 1940</u>. (The Securities and Exchange Commission is a permanent agency of the United States government which regulates the securities industry in the U.S.) /Emphasis in original./

(B) "--Securities issued by any company engaged in the management and/or distribution of such investment companies.

(C) "--Obligations of the United States or Canadian governments, or time deposit accounts in a recognized bank or trust company."

(iii) The prospectus of FOF dated May 3, 1965 does not disclose

(A) that the changes made in transforming paragraph (i)(A) into paragraph (ii)(A) above among other things --

(1) permit FOF to invest in securities issued by registered investment companies, but <u>not</u> registered under the Securities Act, with the consequence that during the period from April 30, 1965 to October 12, 1965, $10,000,000 of the assets of FOF were in fact invested in unregistered securities of The York Fund, Inc., a newly organized investment company controlled by IOS, which owns 45% of the York Management Company, Ltd., the investment adviser of The York Fund, Inc.; and

(2) permit the assets of FOF to be invested in shares of registered investment companies which are primarily engaged in investing in non-United States securities.

(B) that the changes made in transforming paragraph (i)(B) into paragraph (ii)(B) above permit the assets of FOF to be invested in securities of companies "engaged in the management and/or distribution of such companies" which are not publicly-owned, under circumstances where IOS controls and owns a substantial interest in such companies.

(C) the changes made in transforming paragraph (i)(C) into paragraph (ii)(C) above --

(1) permit the assets of FOF to be held in time deposits as an integral, continuing, non-defensive element of its investment purposes; and

(2) permit the assets of FOF to be invested in any bank or trust company, so long as it is a "recognized" (by whom, and upon what criteria, is unstated) bank or trust company, even though the "bank or trust company" has a net worth of less than $5,000,000 under circumstances where IOS wholly owns, controls, and directly or indirectly has interests in banks which under these terms will be eligible to receive time deposits from FOF.

(iv) Since the prospectus of FOF dated May 3, 1965, the investment policy of FOF has been changed to permit it now to invest in securities issued by Canadian investment companies not registered with the Commission, under circumstances where IOS wholly owns I.O.S. of Canada, Ltd., which wholly owns Regent Advisers (1963) Ltd., a Canadian company which manages and underwrites Regent Fund, Ltd., a Canadian investment company which is not registered with the Commission.

e. The prospectus of FOF, the prospectus for the IOS Investment Program for the accumulation of interests in FOF, and the periodic reports of FOF do not disclose the extent to which IOS derives revenues from its operations relating to FOF. In particular:

1913

(i) The semi-annual report of FOF dated June 30, 1965 indicates, in a statement of net assets made a part thereof, that included in the assets of FOF as of that day was "cash, including interest-bearing deposit accounts of $38,400,000," in the total amount of $46,367,600. Note 6 to the financial statement states in relation thereto:

> "Interest-bearing deposit accounts may be maintained by or for the Fund in recognized banks or trust companies. Although I.O.S., Ltd. (S.A.), distributor of the Fund, directly or indirectly has interest in or controls eligible financial institutions, as of June 30, 1965, no deposits have been made in such institutions."

Said Note 6 and said semi-annual report omit to disclose that as of a date or dates prior and subsequent to June 30, 1965 substantial amounts of cash of FOF were deposited with a financial institution which extends a line of credit to Investors Overseas Bank, Ltd., a wholly-owned subsidiary of IOS located in Nassau, the Bahamas, the business of which is lending money to investors, at 6% to 6-1/2% interest per annum, in order to finance their acquisition of IOS Investment Programs for the accumulation of interests in FOF.

(ii) The semi-annual report of FOF dated June 30, 1965 indicates that FOF's portfolio included as of that date 501,743 shares of The York Fund, Inc., an investment company with total net assets of $4,491,500 as of that date. The cost of the FOF investment in The York Fund, Inc. is indicated as $5,050,000 and its "quoted market" value as of June 30, 1965 is indicated to be $4,500,600. The semi-annual report dated June 30, 1965 describes The York Fund, Inc. as follows:

> "The York Fund, Inc. Organized in April 1965 as a registered investment company under the U.S. Investment Company Act of 1940, Fund shares are currently available only to The Fund of Funds, the 'founder-investor.' Its charter permits maximum flexibility in both rising and declining markets. Compensation of the management group is solely on a performance basis. It is hoped that York Fund, with its flexible approach will, over the long term, stay among the industry leaders." /Emphasis in original./

355

Said description omits to disclose:

(A) The "founder-investor" of the fund is not FOF. While FOF is the sole "investor" in The York Fund, Inc., IOS rather than FOF is its "founder." IOS owns 45% of the outstanding stock of York Management Company, Ltd., located at 119 rue de Lausanne, Geneva, Switzerland, the management company of The York Fund, Inc.

(B) Under its investment advisory and management services contract with The York Fund, Inc., York Management Company, Ltd. will receive investment advisory fees computed as the sum of

"(a) 10% of the excess of realized and unrealized securities gains over realized and unrealized securities losses (reduced by the excess, if any, of such losses over such gains in the immediately preceding year), and

"(b) 10% of the net interest, dividends and other income of the Registrant, less

"(c) all amounts which the adviser is required to reimburse Registrant for operating expenses, salaries of officers and employees, directors' fees and office expenses."

(C) The acquisition cost of the 501,743 shares of The York Fund, Inc. owned by FOF included a sales charge (1%), all or substantially all of which has been paid to IOS as the broker-dealer for the buyer (FOF).

(iii) Interests in FOF are offered for sale by means of participations in the IOS Investment Program. The types of investment programs offered to investors under the IOS Investment Program include a "Capital Accumulation Program with Insurance Protection" (CAPINS). The prospectus of the IOS Investment Program dated March 1, 1965 described CAPINS as a plan by which investors are able "to assure completion of all unpaid insured Investment Units <u>in the event of death</u>." /Emphasis in original./ This is done by the deduction from each investor's payment under CAPINS of an insurance permium paid over to the International Life Insurance Company (S.A.) of Luxembourg (ILI). ILI is described in the IOS Investment Program prospectus dated March 1, 1965 as a company which "has

issued a renewable term, group-creditor life insurance policy to Investors Overseas Services on the lives of those investors participating in CAPINS Programs." Said prospectus omits to disclose that 75-1/2% of the stock of ILI is beneficially owned by IOS.

(iv) The prospectus of FOF dated May 3, 1965 at page 6 thereof states with regard to the cost of purchases of securities for the portfolio of FOF

(A) "The cost to the Fund with respect to each transaction will generally be at the minimum rate established by most mutual funds (or securities brokers or dealers, in the case of closed-end fund and management company shares), <u>and may not exceed an aggregate total of 1% during any calendar year</u>. If the total cost of all transactions involves costs to the Fund in excess of 1% (including transfer taxes), Investors Overseas Services, exclusive distributor of the Fund, has agreed to pay such excess." /Emphasis in original./

(B) Said prospectus further states, at page 17 thereof

"As exclusive distributor of the Fund's shares, Investors Overseas Services will retain a portion of the <u>Fund of Funds</u> acquisition charge. The purchase and sale of securities for the Fund's portfolio will normally be placed through Investors Overseas Services as the investment dealer of record, and IOS will share in customary charges, if any, relevant to such transactions. IOS reserves the right to accept or reject all Applications for the purchase of Fund shares and Programs." /Emphasis in original./

Said statements omit to disclose that the "portion of the <u>Fund of Funds</u> acquisition charge" retained by IOS generally totals 75% of the total acquisition charge.

f. The prospectus of FOF dated May 3, 1965 contains a section entitled "HOW TO REDEEM FUND SHARES." Said section states in part that redemption may be suspended in the event

"(ii) the Securities and Exchange Commission of the United States government has by order permitted such suspension . . . ."

Said statement implies that FOF acknowledges that it is subject to regulation by the Commission, when in fact it is not registered pursuant to the Investment Company Act, a fact which is not disclosed.

g. Other inadequate or inaccurate statements of a similar object and purport were made in the offer and sale of interests in FOF and participations in the IOS Investment Program relating to FOF.

5. The prospectus of FOF dated May 3, 1965 states that its quarterly reports to investors "make maximum full disclosure of the activities of the Fund, in accordance with precedent set by U.S. securities law requirements." Said statement omits to disclose that the quarterly reports, which include semi-annual and annual reports, and the prospectus of FOF are not, in fact, in accordance with precedent set by U.S. securities laws requirements and do not, in fact, make full disclosure of the activities of FOF as above stated.

B. VIOLATION OF SECTION 17(d) OF THE INVESTMENT COMPANY ACT AND RULE 17d-1 THEREUNDER

1. On August 28, 1964, a registration statement covering 447,000 shares of Ramer Industries, Inc. (Ramer) was filed with the Commission. As described in the registration statement, the 447,000 shares were initially to be sold by the controlling stockholders of Ramer to Messrs. Robert J. Haft, Rudolph Cohen, Howard Stamer and Mortimer B. Wolf (individual purchasers) at a price of $2.3714 per share. The individual purchasers did not have sufficient capital to acquire all of the shares, and had been unsuccessful in their attempts to obtain loans. Cowett, who at that time was general counsel and a director of IOS, and an officer and director of its subsidiary companies IIT (International Investment Trust) and IIT Management Company (S.A.), undertook to assist in the placement and acquisition of the stock. Cowett and Cornfeld arranged for the individual purchasers to assign 230,000 of the 447,000 shares to be purchased by them to seven assignee purchasers. Cowett and Cornfeld committed IIT to purchase 60,000 shares, and solicited Value Line, Convertible, RIC, Alexander M. Laughlin, Francis H. Cabot and Banque Privee to purchase additional shares of Ramer stock. (Alexander M. Laughlin is a partner of Jesup & Lamont, a registered broker-dealer and New York Stock Exchange member firm to which IOS directs brokerage. Francis H. Cabot is a customer of Mr. Laughlin. Banque Privee is a Swiss bank whose wholly-owned subsidiary, Athold (S.A.), is a distributor of IOS Investment Programs for the accumulation of interests in FOF in French-speaking Switzerland.) Amendment No. 3 to the registration statement of Ramer was filed on December 1, 1964 disclosing that 230,000 shares had been assigned as follows: IIT (60,000 shares); Value Line (50,000 shares); Convertible (35,000 shares); RIC (50,000 shares); Alexander M. Laughlin (5,000 shares); Francis H. Cabot (10,000 shares); and Banque Privee (20,000 shares). The cost of Ramer shares to IIT was $3.00 per share, while the cost of such shares to each of the other said purchasers was $3.25 per share.

2. Both IIT and FOF are affiliated with and under control of IOS and, by reason of such common control, affiliates of each other. FOF owned at the time of the transaction, and presently owns, substantially in excess of 5% of the outstanding shares of each of the three registered investment company assignee purchasers, namely, Value Line, Convertible and RIC. By reason thereof, FOF was and is an affiliate of each of such companies so that IIT was and is an affiliate of an affiliate (FOF) of each of such companies, within the meaning of the Investment Company Act. Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder in general prohibit transactions in which any affiliate or any affiliate of an affiliate of a registered investment company is a joint or a joint and several participant with such registered investment company unless an application for an order permitting the transaction has been granted. No application for such an order relating to the transaction involving the stock of Ramer was filed. Accordingly, IOS, Cornfeld and Cowett wilfully violated and wilfully aided and abetted violations of Section 17(d) of the Investment Company Act and Rule 17 CFR 270.17d-1 thereunder.

C. VIOLATIONS OF SECTION 17 OF THE EXCHANGE ACT

1. During the period from approximately May 28, 1965 to the present Investors Continental Services, Ltd. wilfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-4 thereunder and IOS, Cornfeld, Cowett and Feld wilfully aided and abetted such violations by failing to keep and preserve a communication which is required to be kept and preserved, the text of which is as follows:

February 10, 1965

Mr. Larry Rosen
Geneva

Dear Larry:

This is intended simply to illustrate an additional problem created by the entire ICS-NASD situation.

Whenever an incorrect commission statement comes into New York, whenever a letter written on ICS stationery by someone who is not an NASD registered representative finds its way into the New York office, or whenever there is any correspondence relating to any person who is not NASD approved, Hy attempts to remove such commission statement, letters, or other paper from ICS files. However, there is a strong probability that Hy will not be able to catch everything which should not be put into the ICS files. If Hy is not in the office and the matter is handled in his absence by one of the secretaries, there is an increased probability that an improper item will find its way into the ICS file. 359

As you know, the New York office is a very busy one. Hy attempts to do three or four jobs at once. The volume of paper work is staggering in relation to the number of personnel in the office. All of these factors only increase the danger of something slipping into the files.

As you are probably aware, the ICS files are always open to complete examination by the NASD or SEC. One improper paper in the file, if discovered, could lead to a complete investigation of the entire workings of ICS. Such an examination would include, in all probability, a review of all correspondence coming into the office over a protracted period. Since the correspondence in any period of three or four or five days is bound to include at least one daming letter, you can see that the results could be disastrous.

I do not mean to panic everybody involved by this letter and my letter of even date. I can ask no more than that each person involved do his part in cutting down the extent of our obvious violations.

Best regards

cc: Bernard Cornfeld
Hy Feld
EMC:AW

2. IOS wilfully violated Section 17(a) of the Exchange Act and Rule 17 CFR 240.17a-7 thereunder and Cornfeld, Cowett and Cantor wilfully aided and abetted such violations in that said persons failed to furnish to the Commission, upon demand, at its principal office in Washington, D. C., true, correct, complete, and current copies of certain books and records specified in a demand made upon IOS, by letter of the Commission dated November 29, 1965, relating to transactions effected by IOS with or for customers who are citizens or nationals of the United States, which books and records IOS is required to make, keep current, and preserve pursuant to Rules 17 CFR 240.17a-3, 17 CFR 240.17a-4 and 17 CFR 240.17a-7 under the Exchange Act.

D. WITH RESPECT TO THE QUESTION OF THE PUBLIC INTEREST:

1. IOS made, and caused Value Line, Convertible and RIC to make, in the prospectuses included in their respective registration statements, statements concerning the benefits received by IOS from Jesup & Lamont, a registered broker-dealer and a member of the New York Stock Exchange, in connection with the allocation of brokerage to Jesup & Lamont by such investment companies, as more fully set forth below.

a. IOS has requested or directed certain registered investment companies, the shares of which have been purchased for the portfolio of FOF, to effect securities transactions for their own portfolios with, or to cause a portion of the brokerage commissions on such transactions to be given-up to, certain broker-dealers designated by IOS. The principal broker-dealer so designated by IOS since July 1963 has been Jesup & Lamont, a registered broker-dealer and New York Stock Exchange member firm. As of May 1965, Jesup & Lamont had realized gross commissions as a result of such directed brokerage and give-ups in excess of $1,500,000.

Under these circumstances:

(i) Jesup & Lamont has furnished to IOS research, investment advisory and investment banking services, and Schroeder Boulton, a partner of Jesup & Lamont, has agreed to and has become a member of the board of directors of The York Fund, Inc., a registered investment company all the stock of which is owned by FOF and the management company of which is controlled by IOS.

(ii) Mrs. Gloria Martica Clapp, the registered representative employee of Jesup & Lamont who is credited by that firm with all commissions received by or given-up to the firm as a result of the designations made by IOS, has arranged for the deposit with Fiduciary Trust Company, Ltd., Nassau, the Bahamas (Fiduciary), of most of the more than $750,000 paid to her as of May 1965 by Jesup & Lamont, as her share of the brokerage commissions on all business directed to it or give-ups paid to it at the request of IOS. Fiduciary, in turn, has transferred substantial sums of money to banks controlled by IOS or to banks which have material banking relationships with IOS.

(iii) Mrs. Clapp and her husband, Samuel F. Clapp, directly and indirectly through J. H. Crang & Co. (Nassau) Ltd., have assisted IOS in obtaining work entry permits for

its salesmen to permit them to sell the IOS Investment Program in Nassau, the Bahamas.

(iv) Samuel F. Clapp, directly and indirectly through Fiduciary and J. H. Crang & Co. (Nassau) Ltd., assisted in the procurement for IOS of subscribers to its IIT investment advisory service, "International Economic and Market Reports," at a subscription price of $2,500 per month ($30,000 per year) per subscription. These subscribers have paid to IOS substantially in excess of $100,000.

(v) Samuel F. Clapp has arranged for financial institutions to deposit more than $7,000,000 with banking institutions controlled by IOS or in which IOS has an interest.

(vi) Samuel F. Clapp, a member of the Bar of Massachusetts, directly and indirectly through Fiduciary, has provided IOS and its affiliated companies and persons with legal advice and a variety of other valuable services relating to the business affairs of IOS.

(vii) Samuel F. Clapp has introduced IOS, and caused IOS to be introduced, to persons with whom IOS or various of its subsidiaries have enjoyed valuable relationships.

b. Cowett, as the representative of IOS, made statements to Value Line, Convertible and RIC for the purpose of having such statements set forth in the prospectus of each, as follows:

(i) On May 28, 1965 Value Line filed a prospectus in connection with post-effective amendment No. 22 to its registration statement which states:

> "The Fund has been further advised by a representative of I.O.S. that as to the remaining firm, Jesup & Lamont, no benefits have been received, either directly or indirectly, by I.O.S. or by any of its subsidiaries or affiliates from that firm or from any person associated or affiliated with it."

(ii) On May 20, 1965 Convertible filed a prospectus in connection with post-effective amendment No. 26 to its registration statement which states that Convertible

"has been advised by a representative of IOS that such company has received no benefit in cash or otherwise, directly or indirectly, from the broker-dealer designated by it."

(iii) On September 20, 1965 RIC filed post-effective amendment No. 15 to its registration statement which states that

"certain brokerage commissions were allocated to the firm of Jesup & Lamont at the request of I.O.S....The Fund has been advised by a representative of I.O.S. that no benefit in cash or otherwise has been received, directly or indirectly, from such commissions by I.O.S. or any person or company related to or affiliated with it."

2. Despite the circumstances set forth in Paragraph 1.b. above, IOS made, and caused American to make, in the proxy statement of American, statements concerning the benefits received by IOS from Jesup & Lamont, in connection with the allocation of brokerage to Jesup & Lamont by American, as more fully set forth below:

A proxy statement of American dated October 19, 1965, and filed with the Commission on said date includes the following statement with respect to the brokerage which IOS has requested or directed American to allocate to Jesup & Lamont:

"Management has been advised that neither IOS nor any of its affiliated or related organizations or persons has received any benefits from Jesup & Lamont or any of its employees, directly or indirectly, by reason of such directed brokerage."

3. IOS has requested or directed certain registered investment companies, the shares of which have been purchased for the portfolio of FOF, to effect securities transactions for their own portfolios with, or to cause a portion of the brokerage commissions on such transactions to be given-up to, certain broker-dealers designated by IOS, including Zuckerman, Smith & Co., and Laidlaw & Co., each of which is a registered broker-dealer and New York Stock Exchange member firm. In this context, these companies have entered into the following arrangements, as a consequence of which funds were made available to Investors Overseas Bank, Ltd., a subsidiary of IOS principally engaged in lending money, at 6%

to 6-1/2% interest per annum, to investors who buy interests in FOF on margin and, as collateral for such margin loans, assign their interests in FOF to Investors Overseas Bank, Ltd.

a. In consideration of brokerage commissions directed to it by IOS, Zuckerman, Smith & Co. has induced Cosmos Bank of Zurich, Switzerland to deposit in May 1965 with the London branch of Bankers Trust Company $2,000,000 or more for the credit of Investors Overseas Bank, Ltd., a wholly-owned subsidiary of IOS located in Nassau, the Bahamas. Bankers Trust Company has paid interest on the amount of the deposit to Investors Overseas Bank, Ltd. and, in addition, has extended a line of credit to Investors Overseas Bank, Ltd. equivalent to the amount of the deposit.

To induce Cosmos Bank to deposit $2,000,000 of its funds with Bankers Trust Company for the credit of Investors Overseas Bank, Ltd., Zuckerman, Smith & Co. has agreed to pay Cosmos Bank a sum of money as a "placement fee," which sum is equivalent to approximately 5-1/2% per annum of the $2,000,000 deposited by Cosmos Bank.

To induce Zuckerman, Smith & Co. to enter into and continue this arrangement, IOS has agreed to direct brokerage commissions to Zuckerman, Smith & Co. and, in addition, to pay to Zuckerman, Smith & Co. an amount equivalent to the sum received by Investors Overseas Bank, Ltd. from Bankers Trust Company as interest in respect of the said $2,000,000 deposit. Such interest is paid at the rate of approximately 4-1/2% per annum.

b. In return for give-up brokerage commissions totalling $40,000 directed by IOS, on or about May 20, 1964, Laidlaw & Co. deposited with (lent to) Bahamas International Trust Company (Bitco), Nassau, the Bahamas, $500,000 <u>at no interest</u> to induce Bitco to deposit (lend) a like amount <u>at no interest</u> to Investors Overseas Bank, Ltd. Laidlaw & Co. agreed to leave its deposit with (continue its outstanding interest-free loan to) Bitco as long as Bitco continued its deposit with (interest-free loan to) Investors Overseas Bank, Ltd. Investors Overseas Bank, Ltd., in turn, collateralized the Bitco deposit (interest-free loan) by assigning to Bitco (i) shares of FOF and (ii) interests in The Dreyfus Fund, Inc. and in Fidelity Trend Fund, Inc. (each of which is a registered investment company), which Investors Overseas Bank, Ltd. obtained by assignment from IOS Enterprises, S.A., Geneva, Switzerland.

4. During the period from October to December 1965, IOS caused FOF to place orders to purchase and to purchase an aggregate of $8,500,000 of shares of Fund of America, Inc. or approximately 48% of the outstanding shares of that registered investment company.

The acquisition cost of the shares of Fund of America, Inc. purchased by FOF included a 1% sales charge ($85,000) paid to Investors Planning Corporation of America (IPC), a registered broker-dealer, which is the principal distributor of Fund of America, Inc. IPC in turn has allowed to IOS, as the broker-dealer for the buyer (FOF), 80% of the 1% sales charge, representing the dealer's allowance of the sales charge paid by FOF. In addition, since IOS acquired 80% of the common stock of IPC on July 30, 1965, IOS has an 80% interest in the portion (20%) of the sales charge retained by IPC, and in the management fee paid by Fund of America, Inc. to its investment adviser, a wholly-owned subsidiary of IPC.

III

In view of the allegations made by the staff, the Commission deems it necessary and appropriate in the public interest that public proceedings be instituted to determine:

A. whether the allegations set forth in paragraphs A, B and C of Section II hereof are true and in connection therewith to afford respondents an opportunity to establish any defenses to such allegations;

B. whether the allegations set forth in paragraph D of Section II hereof are true and the extent to which the nature, scope and significance of the activities of IOS, ICS, and companies and persons controlled by, managed by, related to, or directly or indirectly affiliated with IOS or ICS, bear upon the question of the public interest to be determined pursuant to paragraph C of this Section and the effect thereof upon registered broker-dealers, registered investment companies, registered investment advisers, registered national securities exchanges and their members and other companies and persons who are domiciled in or are citizens of the United States; and

C. what, if any, remedial action is appropriate in the public interest pursuant to Sections 15(b) and 15A of the Exchange Act.

IV

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held

at a time and place to be fixed and before a hearing examiner to be designated by further order as provided by Rule 6 of the Commission's Rules of Practice (17 CFR 201.6).

IT IS FURTHER ORDERED that each party file an answer to the allegations contained in the Order for Proceedings within 30 days after service upon him of said Order.

If any party fails to file the directed answer or fails to appear at a hearing after being duly notified, such party shall be deemed in default and the proceeding may be determined against such party upon consideration of the Order for Proceedings, the allegations of which may be deemed to be true.

This Order shall be served upon I.O.S., Ltd. (S.A.) d/b/a Investors Overseas Services, Investors Continental Services, Ltd., Bernard Cornfeld, Edward M. Cowett, Allen R. Cantor, W. Thad Lovett, Robert Nagler and Hyman Feld by service of a copy thereof personally or by certified airmail or registered airmail.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceedings will be permitted to participate or advise in the decision upon this matter except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule-making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed to be subject to the provisions of that section delaying the effective date of any final Commission action.

By the Commission.

Orval L. DuBois
Secretary

SERVICE LIST 1925

Rule 23 of the Commission's Rules of Practice provides that all amendments to moving papers, all answers, all motions or applications made in the course of a proceeding (unless made orally during a hearing), all proposed findings and conclusions, all petitions for review of any initial decision, and all briefs shall be filed with the Commission and shall be served upon all other parties to the proceeding including the interested division of the Commission.

The attached Order for Proceedings has been sent to the following parties:

I.O.S., Ltd. (S.A.) d/b/a
Investors Overseas Services
119 rue de Lausanne
Geneva, Switzerland

I.O.S., Ltd. (S.A.) d/b/a
Investors Overseas Services
7 West 57th Street
New York, New York
c/o Hyman Feld, agent for service

Investors Continental Services, Ltd.
7 West 57th Street
New York, New York

Hyman Feld
7 West 57th Street
New York, New York

Securities and Exchange Commission
Division of Trading and Markets
Lawrence Williams, Branch Chief
425 Second Street, N. W.
Washington, D. C. 20549

Bernard Cornfeld
119 rue de Lausanne
Geneva, Switzerland

Edward M. Cowett
119 rue de Lausanne
Geneva, Switzerland

Allen R. Cantor
119 rue de Lausanne
Geneva, Switzerland

W. Thad Lovett
119 rue de Lausanne
Geneva, Switzerland

Robert Nagler
119 rue de Lausanne
Geneva, Switzerland

(Securities Exchange Act Release No. 8083)

—— 2026

ADMINISTRATIVE PROCEEDING
FILE NO.: 3-497

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

May 23, 1967

In the Matter of I.O.S., LTD. (S.A.) d/b/a INVESTORS OVERSEAS SERVICES (8-8622) INVESTORS CONTINENTAL SERVICES, LTD. (8-6948) BERNARD CORNFELD EDWARD M. COWETT ALLEN R. CANTOR W. THAD LOVETT ROBERT NAGLER HYMAN FELD Securities Exchange Act of 1934	ORDER ACCEPTING OFFER OF SETTLEMENT

On February 3, 1966, the Commission instituted these proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 (Exchange Act) naming I.O.S., Ltd. (S.A.) d/b/a Investors Overseas Services (IOS) (a Panama corporation with principal offices at Geneva, Switzerland, which became registered with the Commission as a broker-dealer on June 10, 1960); Investors Continental Services, Ltd. (ICS) (a wholly owned subsidiary of IOS with principal offices at New York, New York, which became registered with the Commission as a broker-dealer on November 18, 1958); Bernard Cornfeld (president, a director and beneficial owner of more than 10% of the equity securities of IOS and a director and indirect beneficial owner of more than 10% of the equity securities of ICS); Edward M. Cowett (a vice president of IOS and a director of IOS and secretary and director of ICS); Allen R. Cantor (senior vice-president of IOS); W. Thad Lovett (executive vice-president of IOS); Robert Nagler (a director of IOS); and Hyman Feld (president and a director of ICS and an assistant secretary of IOS). The Order for Proceedings alleged violations of:

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(1) the registration provisions of Section 5 of the Securities Act of 1933 and Section 7 of the Investment Company Act of 1940 with respect to the offer and sale of unregistered interests in The Fund of Funds, Ltd. (a foreign investment company whose portfolio consists largely of shares of investment companies registered under the Investment Company Act of 1940) and unregistered participations in the IOS Investment Program which is a program sponsored by IOS for the accumulation of interests in The Fund of Funds, Ltd.;

(2) Section 17(d) of the Investment Company Act of 1940 and Rule 17d-1 thereunder, relating to transactions between International Investment Trust, and investment company affiliate of IOS and The Fund of Funds, Ltd., and certain registered investment companies; and

(3) Section 17 of the Exchange Act relating to an alleged failure to preserve and produce certain books and records of IOS and ICS required to be maintained, preserved and made available for inspection by registered brokers and dealers under said Act.

Respondents have submitted an Offer of Settlement under which they propose that the proceeding be terminated without any findings as to the foregoing allegations, and for that purpose they stipulate and agree as follows:

1. I.O.S., Ltd. (S.A.) ("IOS") is registered with the Commission as a broker and dealer. Investors Continental Services, Ltd., a wholly-owned subsidiary of IOS, is registered with the Commission as a broker and dealer. I.C.S., Ltd., a wholly-owned subsidiary of IOS, is registered with the Commission as a broker and dealer. IOS and I.C.S., Ltd. shall each withdraw its registration as a broker and dealer, such withdrawals to be effective upon the entry of the Order by the Commission based on this Stipulation. Investors Continental Services, Ltd. shall comply with the procedures provided in paragraph 2(a) below. Accordingly, IOS and its affiliates, including The Fund of Funds, Ltd. ("FOF"), International Investment Trust, Ltd. ("IIT") and any investment company affiliated with any of the foregoing which may now or hereafter be organized, their respective affiliates and investment advisers (but only to the extent that the activities of such advisers relate to any of the foregoing persons), shall conduct no activities subject to the jurisdiction of the Commission as hereinafter defined, except as otherwise provided herein.

2. (a) IOS shall, within ninety (90) days after entry of the Order based on this Stipulation, either dispose (after notice to and with the consent of the Commission) of its interest in Investors Continental Services, Ltd. ("ICS") to a person independent of and not directly or indirectly affiliated with IOS or merge ICS into Investors Planning Corporation of America, with the latter as the survivor corporation ("IPC").

(b) Within sixteen (16) months after entry of the Order based on this Stipulation, unless such time is extended in the Commission's discretion, IOS shall sell, transfer or otherwise dispose of its entire interest in IPC to a person who is independent of and not directly or indirectly affiliated with IOS; or within fourteen (14) months after entry of the Order based on this Stipulation by the Commission (unless such time has been extended by the Commission), IOS shall make final arrangements satisfactory to the Commission, in the Commission's sole and absolute discretion, to otherwise remove

IOS from any direct or indirect control over the management and policies of IPC. During such periods, no respondent shall remain or become an employee, officer or director of IPC.

(c) Within one hundred twenty (120) days after entry of the Order based on this Stipulation by the Commission, all IOS interest in IPC shall be placed in a voting trust, the terms and independent trustees of which shall be acceptable to the Commission. The trust shall continue until IOS has complied with the provisions of paragraph (b) above.

(d) IOS shall give the Commission notice of any proposed transaction referred to in paragraph (b) thirty (30) days prior to the effective date thereof, said notice to include a statement of all circumstances of any such transaction, and such transaction shall be effected only upon consent of the Commission.

(e) Upon compliance with paragraph (b), neither IPC nor any officer, director, stockholder or employee of IPC shall own stock of IOS or its affiliates (except for current holdings by such persons as investors in the IOS Investment Program, IIT or FOF), except as otherwise approved by the Commission and except that present IPC employees who own IOS stock at that time may thereafter continue their employment with IPC for no more than one (1) year if such continued employment is reasonably required by the person not directly or indirectly affiliated with IOS referred to in paragraph (b) above, and has been approved by the Commission pursuant to paragraph (d) above.

3. (a) Within five (5) days after entry of the Order based on this Stipulation, The York Fund, Inc., The Alger Fund, Inc., The Douglas Fund, Inc. and Computer Directions Fund, Inc. shall each adopt a plan of complete liquidation and dissolution. Such liquidation shall be effected as to at least 50% of net assets of each such registered company on or before July 15, 1967 and shall be completed on or before October 10, 1967.

(b) Immediately upon the entry of the Order based on this Stipulation, each of said investment companies shall cease to effect any transactions in securities except for purposes of effecting the plan of complete liquidation and dissolution provided herein.

(c) Immediately upon effecting the plan of complete liquidation and dissolution described herein, each of said investment companies shall file with the Commission an application pursuant to Section 8(f) of the Investment Company Act of 1940 for an order declaring that each said company has ceased to be an investment company.

(d) Financial Institutions Growth Stock Fund, Inc. ("FIG") shall effect a liquidation as to all of its net assets except for $1,000,000 (no more than 25% of which shall consist of marketable securities) on or before July 15, 1967, and shall on or before such date file the application set forth in paragraph (c) above. On or before August 15, 1967 FOF shall have either completely liquidated FIG or have sold (after notice to and with the consent of the Commission) its entire stock interest in FIG to a person who is independent of and not directly or indirectly affiliated with IOS.

4. Upon entry of the Order based on this Stipulation, IOS and all of its affiliates shall cease all sales of securities to United States citizens or nationals wherever located, except for (i) offers and sales outside of the United States (and its territories, possessions or commonwealth subject to the jurisdiction of the United States) to officers, directors and full-time personnel of IOS and its subsidiaries; (ii) sales by IPC; and (iii) sales by Pension Life Insurance Company of America, as provided in paragraph 6.

5. (a) Upon entry of the Order based on this Stipulation, no IOS officer, director or employee shall engage in any activity subject to the jurisdiction of the Commission.

(b) While no IOS person, as that term is defined below, has any present intention of terminating his present affiliation with IOS, such person shall not in any event engage in any activity subject to the jurisdiction of the Commission except (i) to the extent necessary to consummate the arrangements referred to in paragraph 2 above, or (ii) upon prior notice to and with the approval of the Commission.

(c) The term IOS person means any person who is a respondent in this proceeding and who at the date of this Stipulation is an officer or employee of IOS or any of its affiliates.

6. (a) IOS and its affiliates, including any of their officers, directors, controlling persons or any persons acting directly or indirectly on their behalf, shall not, except upon prior consent of the Commission, acquire, directly or indirectly, any controlling interest in any financial entity doing business in the United States, including but not limited to a broker-dealer, investment company, investment adviser, bank or similar entity, or any other business whose activities directly or indirectly are subject to the jurisdiction of the Commission; provided, however, that any of the aforementioned persons may purchase interests, including voting securities, in any such financial entity if such interests are not, in the aggregate, controlling interests but, as to investment companies, such purchases shall be subject to the provisions of paragraph 7. The aforementioned persons may, however, acquire a controlling interest in any financial entity whose principal business is without the United States and which carries on no business subject to the jurisdiction of the Commission.

(b) IOS and affiliates may retain their interests in Pension Life Insurance Company of America ("Pension") provided that Pension conducts a normal and customary insurance business. Such business shall not include the offer or sale of variable annuities or other security interests subject to the jurisdiction of the Commission. It is further agreed that Pension shall not make any public offering of its securities unless such offering is made through a registered broker-dealer who is independent of Pension, IOS or any of their affiliates. The foregoing provision shall not apply when Pension is making an offering of its securities on a pro rata basis to its existing stockholders. IOS may transfer its interests in Pension to IPC.

FoF-Pun!

7. (a) IOS will cause FOF, or any other investment company affiliate of IOS, to make only such further purchases of shares of registered investment companies as are within the limitations of Section 12(d)(1) of the Investment Company Act as if applicable.

(b) IOS will not seek or accept directly or indirectly representation on the board of any registered investment company or investment adviser or underwriter (other than IPC, during the periods set forth in paragraph 2(b)) thereto.

(c) IOS will cause FOF, or any other investment company affiliate of IOS, to abide by any law passed by Congress in the future which is applicable to foreign investment companies which invest in whole or in part in shares of registered investment companies, whether or not such law is made directly applicable to such foreign investment companies.

8. Since IOS will, pursuant to the terms and conditions of this Stipulation, conduct all of its securities activities outside the jurisdiction of the Commission and limit all future sales to foreign nationals only, it agrees as a part of this Stipulation to offer, within a reasonable period of time, to persons who purchased interests in FOF who were either members of the armed forces, other employees of the United States, or residents of the United States, its territories, possessions or commonwealth subject to the jurisdiction of the United States, the opportunity of substituting under terms satisfactory to the Commission, shares of registered investment companies for their interests in FOF or of exercising other options which would terminate any continuing or further ownership of FOF interests.

9. IOS and FOF will supply, on a regular periodical basis, information that the Commission may request concerning their operations to show compliance with the terms of this Stipulation.

10. It shall be a breach of the terms of this Stipulation for IOS, or any affiliate, or any person, or any IOS person directly or indirectly controlling or controlled by any of the foregoing, to do any act or thing which would be a breach of this Stipulation through or by means of or on behalf of any other person, including any individual, corporation, partnership, association, joint stock company, business trust or unincorporated organization.

11. If at any time, subsequent to the acceptance of this Stipulation, it appears that any term or condition of the Stipulation has been breached by respondents, the Commission may, upon thirty (30) days notice to respondents, order a hearing be held at a place designated by the Commission to determine only whether a breach of such Stipulation occurred and to afford respondents an opportunity to deny that a breach occurred or to establish mitigating circumstances with respect to such breach. For the purposes of such proceedings, service

may be duly made on respondents by mailing a copy of the notice for hearing to the last known address of IOS. If respondents fail to appear at such hearing, of which they have been duly notified, or upon such hearing if the Commission finds a breach of any term or condition of the Stipulation, the Commission may, without further proceedings, deem respondents to be in default of its Order for Proceeding In the Matter of I.O.S., Ltd. (S.A.), et al., of February 3, 1966 and may determine such proceedings against respondents in accordance with the provisions of Rule 7(e) of the Commission's Rules of Practice.

12. Definitions. The terms used in this Stipulation, except as set forth below, are those used in the Securities Exchange Act of 1934.

"Affiliate" means (i) any company or person directly or indirectly owning, controlling or holding 1% or more of the securities of IOS or 5% or more of the securities of any subsidiary of IOS; (ii) any company or person, 5% or more of whose securities are directly or indirectly owned, controlled or held by IOS or any of its subsidiaries; (iii) any person directly or indirectly controlling, controlled by or under common control with IOS or any of its subsidiaries; and (iv) any officer or employee of IOS or any of its subsidiaries. For purposes of this Stipulation, the term "affiliate" shall also include an affiliate as defined in Section 2(a)(3) of the Investment Company Act of 1940, of an affiliate of IOS. "Subsidiary" means any company, 10% or more of the outstanding voting securities of which are directly or indirectly owned, controlled or held with power to vote by IOS. Provided, however, that the companies, other than those named in paragraph 3 herein, whose securities were owned by FOF and IIT on April 27, 1967 shall not be deemed affiliates of IOS solely by reason of the relationship with and extent of such ownership on the aforesaid date.

"Investment company affiliate of IOS", for the purpose of paragraph 7(a) above only, shall not include the IOS Investment Programs for the accumulation of shares of Dreyfus Fund and the IOS Investment Programs for the accumulation of shares of Research Investing Corporation so long as the shares of Dreyfus Fund and Research Investing Corporation held by said

IOS Investment Programs are voted at any regular or special meeting of stockholders for quorum purposes only and are not voted on any matter which may be voted upon at any meeting.

"Jurisdiction of the Commission" shall include, but shall not be limited to, any activity in connection with the conduct of any securities business (which shall include the offer, purchase or sale of a security or the delivery or payment after sale) involving:

(a) any use of the United States mail, including all A.P.O. mail;

(b) any use of the means or instrumentalities of trade, commerce (including the facilities of a national securities exchange), transportation or communication within or between any state, territory, possession or commonwealth of the United States;

(c) any means within the District of Columbia or on any military base, embassy, consular post or ship of the United States; or

(d) any use of the means or instrumentalities of trade, commerce (including the facilities of a national securities exchange), transportation or communication between any foreign nation or ship and any state, territory, possession or commonwealth of the United States or the District of Columbia or any military base, embassy, consular post or ship of the United States.

13. Respondents waive:

(1) A hearing pursuant to Section 15(b) of the Securities Exchange Act of 1934;

(2) All post-hearing procedures pursuant to Rules 16 and 17 of the Commission's Rules of Practice; and

(3) Judicial review by any court.

After due consideration the Commission has determined that it is in the public interest to accept respondents' Offer of Settlement and accordingly

IT IS ORDERED that the Offer of Settlement be, and it hereby is accepted, the terms and conditions of which shall become effective on June 5, 1967.

By the Commission.

Orval L. DuBois
Secretary

Nollye A. Thorsen

By Nollyo A. Thorsen
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
TRADING AND MARKETS

2.95

July 18, 1966

Mr. Edwin D. Etherington, President
American Stock Exchange
86 Trinity Place
New York, New York 10006

Mr. Frederick Moss, President
Boston Stock Exchange
53 State Street
Boston, Massachusetts 02109

Mr. Charles H. Steffens, President
Cincinnati Stock Exchange
209 Dixie Terminal Building
Cincinnati, Ohio 45202

Mr. Roy F. Delaney, President
Detroit Stock Exchange
2314 Penobscot Building
Detroit, Michigan

Re: Commission Rate Structure

Mr. James E. Day, President
Midwest Stock Exchange
120 South LaSalle Street
Chicago, Illinois 60603

Mr. Edward T. McCormick, President
National Stock Exchange
6 Harrison Street
New York, New York

Mr. G. Keith F[illegible]ston, President
New York Stock Exchange
11 Wall Street
New York, New York 10005

[illegible] Thomas P. Phelan, President
Pac[illegible]fic Coast Stock Exchange
301 Pine Street
San Francisco, California 94104

Mr. Elkins Wetherill, President
Philadelphia-Baltimore-Washington Stock Exchange
1401 Walnut Street
Philadelphia, Pennsylvania

Mr. Ralph S. Richards, Jr., President
Pittsburgh Stock Exchange
333 Fourth Avenue
Pittsburgh, Pennsylvania

2296

Mr. George J. Potter, President
Salt Lake Stock Exchange
39 Exchange Place
Salt Lake City, Utah

Mr. G. C. George, President
Spokane Stock Exchange
206 Radio Central Building
Spokane, Washington

Mr. A. B. Harrisberger, President
Colorado Springs Stock Exchange
418 Mining Exchange Building
Colorado Springs, Colorado

Mr. Robert W. Haack, President
888 Seventeenth Street N.W.
Washington, D. C. 20006

Gentlemen:

This letter is separately addressed to each of the national securities exchanges and to the NASD. It relates to the problem of "give-ups" and reciprocity in all securities markets. The problem is discussed in the Report of the Special Study of Securities Markets and has for some time been the subject of informal discussions between representatives of the Commission and the securities industry. We have found a general recognition in the industry that the "give-up" practice in the exchange communities has developed to a point where it threatens the integrity of wide segments of the securities industry. [In this connection, we consider it significant that "give-ups" in the over-the-counter market have long been recognized to be improper and illegal.] In the exchange communities, however, we understand that the pressure of competition among participants in the "give-up" practice is such as to deter any one of the self-regulatory agencies, acting alone, from taking the initiative in putting an end to the practice. Accordingly, it appears that the solution of the problem may require coordinated action by each of the national securities exchanges, by the NASD and by the Commission. It may be necessary to have simultaneous compliance in all markets to eliminate the improper practices. We recognize that it may be necessary for the Commission to adopt rules to supplement those of the national securities exchanges and of the NASD to provide a comprehensive and uniform approach to this matter.

The purpose of this letter is to summarize our position on "give-ups" and to delineate the kinds of commission splitting which we believe should be prohibited, as well as to solicit your views as to the specific action the Commission, the exchanges and the NASD should take to eliminate the abuses involved.

The "give-up" practice with which we are concerned grows out of the rules of the national securities exchanges which provide for uniform rate structures but permit the sharing of commissions among members and to some extent between members and nonmembers. While perhaps originally designed merely to provide for a reasonable sharing of the commission among those who combine to perform a service for a customer, the practice has developed of permitting the "give-up" to be directed to persons who neither perform any function with respect to the order nor are necessary to its consummation. The give-ups are, for the most part, directed by or on behalf of persons who are nonmembers of the exchanges and not for the benefit of the customer on whose behalf the order is executed.

At the outset we should state our belief that the commission should fairly compensate a broker for the services which it performs. We have already noted the recognition that give-ups in the over-the-counter market are inconsistent with the legal responsibilities of the parties involved. As for the Exchange markets, assuming that a fixed minimum commission schedule is necessary and appropriate to effective and efficient operation of an Exchange, it is our view that give-ups and other similar arrangements which directly or indirectly arise out of customer direction or are for the customer's benefit, are inconsistent with this premise and have the effect of providing a rebate. Such rebates are prohibited by Exchange rules. A rate structure should also provide equitable treatment for various classes of customers whose use of Exchange facilities is basically similar. As the Exchanges' rules recognize, it should not encompass rebates directly or indirectly to particular classes of customers. Such rebating is not only discriminatory but raises questions as to the propriety of the commission rate structure itself. A customer directed give-up is inconsistent with all of those principles. Not only does it deprive brokers of a portion of their commissions but it indirectly operates as a rebate in favor of those customers who happen to be able to derive a benefit from directing brokerage commissions to firms having no meaningful participation in the execution of the orders. This discriminatory effect is aggravated where the benefits of the rebate flow not to the customer itself but to others, such as investment managers who are in a position to direct the customer's brokerage. Furthermore, the availability of indirect rebates through customer directed give-ups creates various distortions and artificial devices in the securities markets which are designed to facilitate a wider distribution of give-ups but in the process may interfere with the orderly functioning of the markets and the most

effective execution of customers' orders. The directed give-up also seriously complicates the administration and assessment by the Exchanges and the Commission of the reasonableness of commission rates since commissions received and retained cease to be related to the expenses incurred for services rendered in the execution of brokerage orders (or indeed, the commission business) on the Exchange.

It is our view that to avoid these problems, the services for which a participating broker is compensated should (a) be necessary for the completion of the transaction, (b) involve functions not performed by the transmitting or executing broker, and (c) not be directed by or on behalf of a public customer.

The Commission does not object to splitting commissions between members where the member originating the order is not equipped to perform the floor brokerage or clearing function. Under these circumstances, we would expect that the normal correspondent relationship would be continued, the rates negotiated, and the floor brokerage and clearance done in an efficient and necessary manner with appropriate compensation. Stated another way, we are not suggesting that bona fide correspondent arrangements by firms which result in a sharing of commissions would be inappropriate unless such arrangements and the commissions paid to the correspondent arise directly or indirectly out of customer request, direction, or understanding.

Conversely, it would not be appropriate for a transmitting or executing firm to use a wide variety of clearing firms in order to obtain a wide dispersion of commission income. Such a procedure would exacerbate regulatory problems and would constitute, in our view, an indirect rebate to the customer. Similarly, it would be inappropriate for a transmitting firm to use a wide variety of executing firms on a particular order. There are simpler and more direct methods other than by splitting commissions for members to fulfill among themselves obligations unrelated to the execution and consummation of commission transactions.

In short, the commission rate structure should provide for compensation for members' services and not permit rebating for customer benefit through the device of unnecessary or duplicative paper work. This letter of course is not addressed to the appropriate level of commissions or to the nature of services which are rendered generally by transmitting or originating firms which are covered by the minimum commission.

A question might be raised whether the approach set forth above will not result in the fragmentation of orders among many transmitting or executing firms by customers who seek to reward a number of brokers. The Commission believes institutions and others acting in a fiduciary capacity are under

a legal duty to obtain the best execution for their principals. We believe that the direction of orders to firms by customers who hold such a fiduciary relationship to others should and normally will be done in a manner entirely consistent with their best execution. We can exercise our jurisdiction to that end.

Closely related to the foregoing is the question of volume discounts. None of our national securities exchanges have rules providing for direct volume discounts although institutional membership on exchanges has provided, indirectly, savings to the underlying shareholders of some such institutions. At the present time the commissions given away by transmitting or executing firms do not inure to the benefit of the great number of small customers who indirectly invest through institutional media. Since such commissions as are now given away do not reduce the cost to the executing brokers and are received by persons having little or nothing to do with the order, we believe it is appropriate for all exchanges to consider a volume discount for such customers. We believe that a discount should be so devised that it will not restrict the normal discretion of a customer or broker as to the manner or timing of the execution of orders.

We do not wish to place a customer in a position of having to execute substantial orders in a short period of time in order to obtain a discount when prudent judgment might dictate otherwise. We request, therefore, that the exchanges consider the amount of an appropriate volume discount, the appropriate break-points for such discounts, the definition of "an order" and whether such discounts should apply to transactions in size for a particular customer during a day, week or longer period. Among the problems we wish to consider is the relationship between volume discounts and executions on more than one Exchange. Although the subject of volume discounts is linked to the problem of give-ups, we do not intend to suggest that volume discounts need necessarily be uniform among all exchanges or that the resolution of either matter should be a condition precedent to making progress with the other.

We are anxious to receive your written suggestions and comments on or before August 15, 1966. In the meanwhile, if you have any questions, please do not hesitate to communicate with the undersigned or Mr. Eugene H. Rotberg, Associate Director for Markets and Regulation.

Sincerely yours,

Irving M. Pollack
Director

ACROSS THE PRESIDENT'S DESK

A Periodic Report to the Exchange Community
from G. Keith Funston

Issue #13
February 1, 1967

2446

On December 16, 1966, I reported in the 11th issue of "Across the President's Desk" that the publication of the SEC Mutual Fund Report had cleared the way for a full review by the Special Committee on Member Firm Costs and Revenues of the Exchange's commission structure and rates. As part of that review, the Committee plans to report to you from time to time on different facets of the commission question, and to seek your comments and suggestions. The first such report follows and it's about "give-ups".

As spokesmen in discussions with the SEC in this area for the Exchange Community with the responsibility for recommending a healthy commission structure for the years immediately ahead, the Committee at this point would much appreciate your views on this most important subject.

It would be helpful if each comment would include reasons for opinions expressed and state clearly whether the views expressed are those of an individual member or allied member or whether they represent a current official opinion of a member organization. The Committee thus hopes with your help to reflect the views of the entire member firm community as it formulates its final recommendations.

You may address your replies either directly to me, to James F. Burns, Jr., Committee chairman, or to any of the Committee members. Their names appear on the last page.

Definition of "Give-up"

The term "give-up" as used by the SEC includes the sharing of a commission by (a) giving up part of the work involved in an order by giving up the name of another member firm on the floor of an exchange or in its clearing house, and (b) the payment by check of part of the commission on an order to another member firm of an exchange (or as permitted by rules of certain regional exchanges to NASD or "preferred list" firms) which may perform no function whatsoever in respect to the origination, execution or clearance of the transaction.

Problems before the Committee

The Special Committee on Member Firm Costs and Revenues has been discussing give-ups with the SEC for some time. The members of the Committee have had an opportunity to become intimately acquainted with the present rigidity of the views of the members of the Commission.

A careful reading of four paragraphs of the SEC Mutual Fund Report reproduced later in this report will indicate that

(1) The SEC does not suggest - it demands - the adoption of rules by all securities exchanges to prohibit customer-directed give-ups (with certain exceptions).

(2) The SEC does not suggest - it demands - the adoption of a volume or institutional discount not necessarily uniform among all securities exchanges.

(3) If such revisions of the rules are not made then

(a) the propriety of the commission rate schedule may be subject to question by the SEC;

(b) the Commission may find it essential to exercise its rule making powers under the Exchange Act; and

(c) the Commission may find it necessary, after thorough consideration, to recommend that broker/dealers be prohibited from acting as brokers for or sharing in the brokerage commissions paid by mutual funds whose shares they sell.

In considering possible solutions of these problems let it be emphasized that at all times the Committee has been guided by two basic concepts - the promotion of the central market for listed securities on this Exchange, and the economic health of NYSE members and member firms - both of which in the Committee's view are essential to maintaining and improving investment service to the public.

Present use of "Give-Ups" and "Payments by Check"

Three major types of practices within this area are presently used by member firms of the NYSE.

Broker's convenience Give-Up

First, brokers use the term "give-up" in talking about a basic agency relationship where one broker requests another to do part of the work on a transaction. For example, a St. Louis member firm may not have its own member on the NYSE floor, but instead may have a New York correspondent member execute and clear its NYSE trades. Or a firm whose floor broker may have too many orders to handle promptly at a given moment may give some of them to a $2 broker. In such instances, parts of orders and fractions of commissions are given up solely for the convenience of the member organization originating the order.

Customer directed Give-Ups

The second type of practice is the giving up of part of a commission at the direction of a customer. One such instance occurs when a customer of a Cleveland member firm vacationing in Florida uses the facilities of another member firm with a Florida office to enter orders for his account at the Cleveland firm. The Florida office clearly does work in connection with the order and is clearly entitled to a give-up of part of the commission.

A variation occurs when a customer makes an investment decision based on advice from one member firm, but places his order through another with instructions to give-up part of the commission to the firm which furnished the investment advice.

There are, of course, immensely more complicated examples, such as a Hartford bank which in tracing services given in connection with an order to sell a foreign copper stock for a trust account might realize that it had been helped by several member firms: Firm A in Hartford has been supplying current market quotes on this stock because of its convenient access by local telephone. Firm B in New York two weeks ago submitted a depth analysis of the electrical industry which referred to copper's changing use by that industry. Firm C had furnished an overall analysis of the metals industries. Firm D which does a large international business had contributed to the decision, too, by a report on business conditions in the copper producer's country. Analysts of both Firms C and D had been consulted in person by the bank's portfolio manager. As the block to be marketed was several thousand shares, the bank wanted the actual sale on the Exchange floor handled by Firm E, which has an excellent block placement department within the firm, sometimes takes clean-up positions for its own account, and regularly

uses a $2 broker in Firm F who has given excellent service in marketing blocks on the floor at advantageous prices. In placing the order, therefore, the bank might request that the commission be shared among six different firms. This is often done by giving part of the physical work involved in handling the order to each firm. For example, the Hartford firm could receive the order and transmit it to the lead broker in New York, who might give portions of the order for which its block department found crosses to floor brokers in Firms B and C. The lead broker might give the work of clearance to Firm D. Thus the firms which contributed to the generation of the order would all share in its execution and settlement.

HARTFORD BANK BLOCK SALE OF FOREIGN COPPER STOCK

Member Firm	Contribution	Participation
Firm A	Supplied quotes	Transmit to lead broker
Firm B	Electrical industry analysis	Execute crosses
Firm C	Metals industry analysis	Execute crosses
Firm D	Foreign economic report	Clearance
Firm E	Lead broker, block placement	Carry account
Firm F	Handling floor trades	Floor brokerage on orders found on floor

OR

Firms E and F can execute and clear, with give-up checks to A, B, C and D.

Give-Ups to Nonmembers

The examples above involve give-ups to other members of the NYSE of commissions arising from NYSE transactions. In recent years, however, pressure from institutional customers and reciprocity has brought about a variety of arrangements by which give-ups are directed to securities firms which are not NYSE members. These arrangements are based on

transactions on regional exchanges or over-the-counter, but they are frequently made possible by NYSE commission dollars.

Regional exchange rules make it easier to split commissions on regional exchange trades than on NYSE trades. In fact, all but one of the major regional exchanges permit commission splitting with nonmembers. Five of them provide that up to 40% of nonmember commissions may be given to any member of the NASD. A sixth provides that up to 25% of nonmember commissions may be given to any securities firm or financial institution which is on its "preferred list". To get on the list, it is necessary only to pay a small fee and agree to certain restrictions, the effect of which is to prevent the 25% split from being passed on to the ultimate customer.

Section 3(a)(3) of the Securities Act of 1934 includes in its definition of a "member" of a securities exchange any person who receives a special rate of commission. The SEC has not clarified the status of those who receive preferred rates of commission under regional exchange rules.

Regional exchange trading

The more permissive commission splitting rules of most regional exchanges have created pressure to execute orders in dually listed securities there. The first result of the pressure has been that crosses in dually listed stocks, where both sides of the trade have been developed by one firm and the liquidity and depth of the NYSE market are consequently not needed, have been taken away from the NYSE floor and put on regional exchange floors.

Based on our estimates of regional exchange volume, regional crosses of 5,000 or more shares have increased as a percent of reported NYSE volume from 1.2% in 1965 to 2.0% in the first six months and 3.0% in the last five months of 1966.

The placing of crosses on regional exchanges, while it has gone part of the way toward satisfying the demand to split commissions with nonmembers, has not proved sufficient to satisfy the total demand. Continued pressure has resulted in block trades on regional exchanges when only one side of the trade has been developed by the member firm. A member firm holding an institutional block order to sell which needs the depth and liquidity of the NYSE for execution buys the block as principal on a regional exchange and as simultaneously as possible sells the same number of shares on the NYSE. The commission charged on the regional exchange is split with nonmembers of either exchange, as permitted under the rules of the regional exchange.

Another indication of the pressure to split commissions with

nonmembers on trades in NYSE listed securities is the creation of trading losses for the purpose. An example is a so-called arbitrage between a regional exchange and the NYSE, in which an apparent profit of 1/8 or 1/4 is created by the price differential. Actually, the profit is more than offset by the 50% commission charged by the regional only member for execution and clearance. As an example, a regional only member might have a market order to buy 100 shares where the offer on the NYSE was 32. The regional only member would approach a dual member with an offer to buy at 32 1/8. The dual member would buy 100 shares on the NYSE as principal at 32 and sell 100 shares on the regional exchange at 32 1/8 as principal to the regional only member, who in turn would charge 50% of the nonmember commission to execute and clear the trade. The net result would be that the dual member would make a "profit" of $12.50, but would pay $17 for execution and clearance to the regional only member. The customer of the regional only member, incidentally, would pay 1/8 over the NYSE offering price in addition to a full commission.

A further indication of the pressure to split commissions with nonmembers is the use of trades executed on regional exchanges as a basis for give-ups, even though institutional customers directing the give-ups had nothing to do with the trades. For example, a dual member executes odd-lot orders on a regional exchange and also round-lot orders for 100 shares where the regional exchange can supply a market. Under regional exchange rules, commissions arising from these trades may be split with regional only members, NASD members, or those on a "preferred list". The regional exchange rules do not specify that commissions may be split only at the direction of the customer for whom the trade was effected. As a result, the dual member uses all his regional trades as a basis for give-ups even though the customers for whom trades are made have no knowledge of how their commissions are being used. The mechanics are simple. The firm keeps a record of commissions earned on the regional exchange and gives up the allowable percentage at the direction of institutions which may have had nothing to do with the trades.

A similar practice has arisen in the over-the-counter market. Some member firms keep a running total of commissions earned on over-the-counter trades, and give-up 50% of those commissions to NASD members at the direction of institutional customers. As before, the customers for whom the trades are effected do not know their commissions are being used in this way.

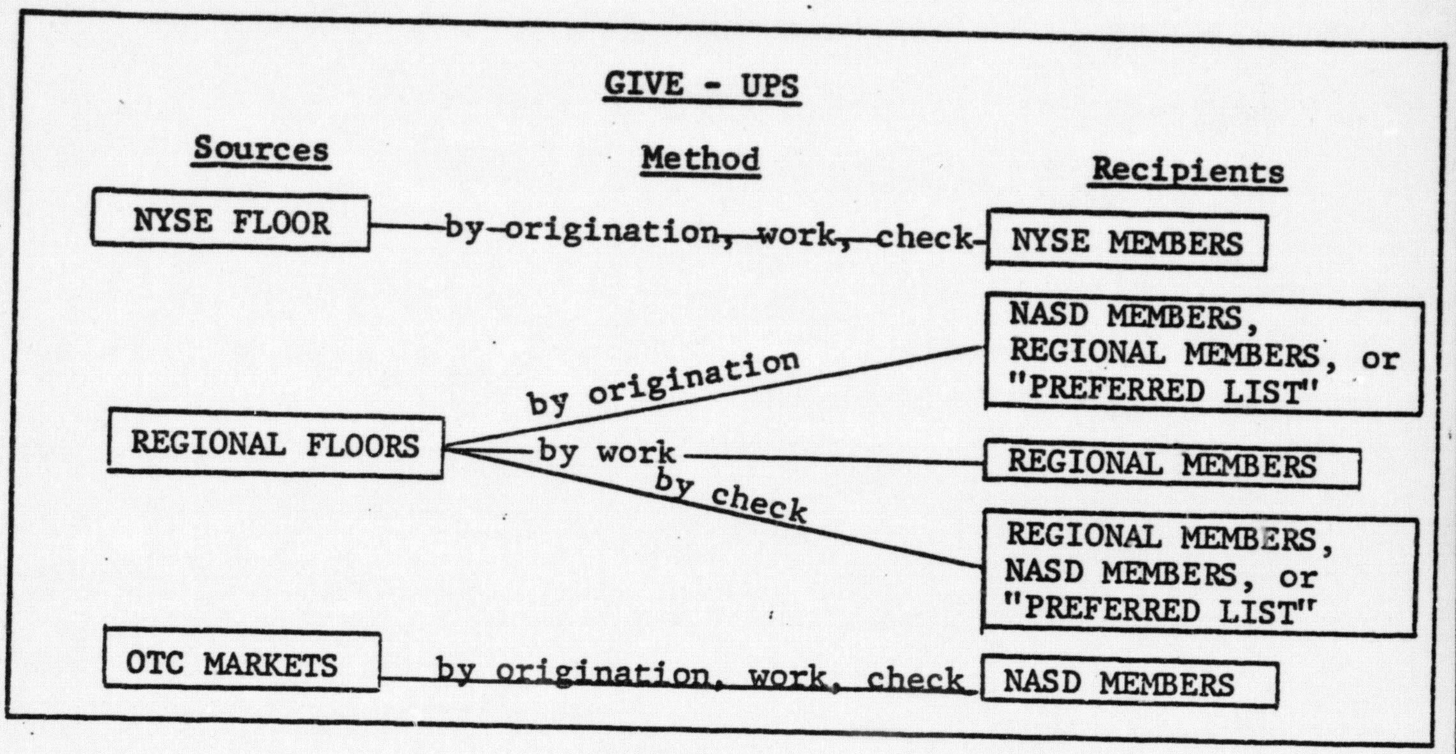
Yet another example of a way of giving commissions to regional only members is the practice on one regional exchange of placing the name of a regional only member in the clearance as a guarantor of settlement. In this case, the dual member executes and clears the transaction while the regional only member collects 50% of the commission,

less floor brokerage because he did not execute, for his role as guarantor.

While it may make no difference to an individual member firm whether it executes on the NYSE and gives part of the commission to an NYSE member or executes on regional exchanges and gives part of the commission to a nonmember, the method used does make a difference to our Exchange members and to the member firm community as a whole. Orders in dually listed securities on regional exchanges, with the give-ups to NYSE nonmembers described above, inevitably reduce commission income to NYSE member firms collectively by the amount given up to the nonmembers. This is aggravated by the more liberal commission splitting rules of the regional exchanges. It affects both firms which are members of the NYSE only and those which also belong to regional exchanges.

There is also an important difference to the public whether orders are executed on the NYSE or on regional exchanges. By far the majority of round and odd-lot public orders at prices away from the market are left with brokers or specialists on the NYSE floor, where they have the advantage of being represented in the central market place. When trades are diverted from the NYSE to regional exchanges for commission splitting reasons, customer orders on the NYSE floor lose an opportunity to be executed, to the disadvantage of those customers. This is particularly true for diverted trades at prices away from the last previous sales on the NYSE.

It is interesting to note that give-ups on regional exchanges to nonmembers of this Exchange are of two distinct types, each of which would be differently affected by different ways of limiting give-up practices. Regional only members can execute and clear trades and receive a portion of the commission for these services. If give-ups by check were not permitted regional only members could thus continue to share in the commissions on orders they do not originate by performing some work on the execution or clearance. On the other hand, NASD members and those on a "preferred list" could no longer share in commissions on such orders if give-ups by check were abolished as they could do no work on the order - they could under such circumstances get a split only on orders they originated.



It is believed that many members and allied members are unaware of the extent of the incursion against the minimum commission caused by give-ups to nonmembers.

Questions raised by the SEC

The questions raised by the SEC on give-ups directed by mutual funds are inextricably tied with other matters such as -

(1) the prohibition of all customer directed give-ups;

(2) the question of the propriety of the commission rate structure because of the widespread practice of giving half or more of the commission on large orders to brokers who performed no identifiable work on the order;

(3) volume discount; and

(4) the rule making authority of the Commission in respect to commission charges under Section 19(b) of the 1934 Act.

The Committee recommends to members and allied members that they read Chapter 4 of the SEC Mutual Fund Report for understanding of the SEC view on give-ups. Here are the highlights from the summary on give-ups, with our underlining added for emphasis:

(e) Federal regulation—The need for action

Since the publication of the Wharton Report and the Special Study, the use of mutual fund brokerage as extra cash compensation for sales of fund shares has been the subject of extensive study and consideration by the Commission. Information gathered from expanded disclosure and reporting requirements under the Act, informal investigations, and discussions between Commission representatives and members of the securities industry regarding mutual fund reciprocal and give-up practices has confirmed and emphasized the problems raised by the Wharton Report and the Special Study. Since this report deals largely with mutual funds, it has discussed use of mutual fund brokerage as additional sales compensation primarily in terms of its impact on funds and their shareholders. It should be emphasized, however, that other institutional investors employ similar techniques. Apart from the purposes of, and impact on, such investors, the Commission is of the view that certain aspects of these practices, particularly the customer-directed give-up, impair the orderly and proper functioning of the securities markets themselves.

(f) Customer-directed give-ups

In the over-the-counter markets, where brokerage costs are subject to negotiation, give-ups of commissions to brokers who perform no necessary function in connection with a transaction have long been recognized as improper and illegal. Give-up practices have been tolerated in the exchange markets only because brokerage costs are fixed by the exchange minimum commission rate schedules. They have become widespread because these schedules have not distinguished between large or small orders and the services sought by or provided to large institutional investors.

Exchange give-up rules may have been originally designed to provide for a reasonable sharing of commissions among those who combined to perform services for customers through traditional correspondent relationships. However, mutual fund give-up practices are wholly inconsistent with this purpose. They permit mutual fund managers to distribute the commissions that the funds pay among securities firms which have nothing to do with the transactions on which the commissions are earned and for services which are of little or no relevance to the interests of the funds' shareholders.

Customer-directed give-ups raise questions as to the propriety of the commission rate schedule itself. Assuming that a minimum commission schedule is necessary and appropriate to effective and efficient operation of an exchange, the commission rate structure should be designed to compensate brokers fairly for the services they perform and to provide equitable treatment for various classes of customers whose use of exchange facilities is basically similar. As existing exchange rules recognize, it should not give direct or indirect discriminatory rebates to particular classes of customers.

Mutual fund give-up practices are inconsistent with these principles. They create rebates not to the brokerage customer, the fund itself, but to its managers who are in a position to direct the fund's brokerage to maximize sales of fund shares. Moreover, the availability of such rebates creates distortions and artificial devices in the securities markets. Give-up practices may facilitate a wider distribution of fund brokerage, but in the process they interfere with the orderly functioning of the markets, the effective execution of customer orders and the channeling of competitive forces for the benefit of public investors, and, as has been noted, they have other undesirable effects on the mutual fund industry.

The give-up is the principal device whereby fund managers are able to channel brokerage commissions to large numbers of dealers in fund shares who do not and are not in a position to perform any useful or necessary function in connection with the transactions on which the commissions are earned. Hence the give-up is in large measure responsible for the increasing importance of brokerage commissions in the competition for sales.

Accordingly, the Commission has given notice that it believes that exchange rules must be changed so as to preclude customer-directed give-ups. Since competitive pressures among participants in give-up practices may deter any one of the exchanges, acting alone, from taking the initiative in this area, concerted action by the exchanges, the NASD and the Commission will probably be necessary. To provide a comprehensive and uniform approach to this matter, the Commission may find it essential to exercise its rulemaking powers under the Exchange Act.

Rules abolishing customer-directed give-ups should reach all existing or future practices which achieve the same purposes now accomplished by present mutual fund give-up practices. Such rules need not interfere with commission splitting among members as a result of traditional correspondent practices whereby the broker receiving an order has a bona fide brokerage relationship with the customer but shares the commission with a correspondent who executes and clears the transaction through the facilities of an exchange. Such commission-splitting is confined to brokers who share the duties, responsibilities, and obligations involved in the handling of the transaction on which the commission is earned. It is quite different from mutual fund commission-splitting which is directed by the fund managers for the purpose of paying brokers for services extraneous to the brokerage function.

The abolition of customer-directed give-ups would appear to have only a slight effect on the gross income of the securities industry. The Booz-Allen study indicates that combined give-up and reciprocal business from all sources accounted for only 2.5 percent of the 1965 gross income of the 2,453 firms studied.[114] Gross income from give-ups and reciprocals from all sources exceeded 5 percent of gross income for only one size group of broker-dealers—the 37 dealers whose gross income ranged from $185,000 to $200,000 in 1964.

Decrease in commission income also at issue

The SEC couples its give-up recommendations with a request for a volume discount, summarized in the Mutual Fund Report as follows (our underlining added):

(g) Reciprocity and exchange commission rate schedules

Reciprocal business practices, i.e., the selection of executing brokers by mutual fund managers on the basis of the brokers' sales of fund shares, raise slightly different issues. The adverse effect of reciprocal practices on the functioning of the securities markets, as distinct from their effect on mutual funds and their shareholders, is not as clear as in the case of give-up practices.

Reciprocal practices, however, do have an adverse effect on mutual funds and their shareholders. They exert pressure upon the exercise of managerial discretion in allocating brokerage between sales and nonsales services, in formulating investment policies and decisions and in executing portfolio transactions. They exert a hidden influence on retail dealers' recommendations to investors and result in unwarranted competitive disadvantages for small funds and small dealers, particularly nonexchange dealers, in competing for sales of fund shares with large funds and large member dealers. They also channel the competition for the funds' portfolio brokerage business among markets and brokers in a manner which benefits fund managers rather than mutual fund shareholders.

It probably is not practical to deal with reciprocity by modifying exchange rules to prohibit these practices except in situations where brokerage allocation is employed to evade the prohibition of give-ups. The Commission believes, however, that the adverse effects of mutual fund reciprocal practices can be substantially mitigated through changes in exchange minimum commission rate schedules to provide a discount for the execution of large block transactions or otherwise take into account the generally lower costs to brokerage firms of executing transactions for the larger institutional investors. Existing give-up practices show that exchange members find it profitable to execute mutual fund portfolio transactions for 40 percent or less of minimum commission rates. These savings can be passed to the multitude of small investors who participate in the securities markets through institutional media if exchange minimum commission rate schedules are revised to provide for meaningful volume or institutional discounts.

Accordingly, the Commission has advised the national securities exchanges that it considers the question of changes in commission rate schedules to be closely related to that of the adoption of rules prohibiting customer-directed give-ups. It has asked the exchanges to consider appropriate changes in their commission rate schedules for the benefit of small investors who participate in the markets through institutional media. Such changes should not restrict the normal discretion of a customer or broker with respect to the timing of orders and the manner of executing them. Institutional customers should not be placed in the position of having to execute substantial orders in short periods of time contrary to the dictates of prudent investment judgment in order to reduce their brokerage costs. A meaningful volume or institutional discount therefore requires consideration of a number of factors including the amount of such discounts, the appropriate breakpoints for such discounts and the definition of an "order."

Although the subject of volume or institutional discounts is closely linked to the give-up problem, there are differences. In the Commission's view it is essential that uniform action be taken to abolish the customer-directed give-up on all exchanges. It is not as clear that the nature and extent of volume or institutional discounts necessarily should be uniform among all exchanges. More important, concurrent resolution of both matters is not a necessary condition to the resolution of one or the other. The Commission has, however, initiated discussions of both matters with the exchanges. It is important that appropriate solutions to these matters be carefully considered and promptly resolved.

The Commission will consider the need for other changes in connection with the introduction of a volume or institutional discount. However, at the present time there is no evidence that a volume or institutional discount will require any such changes.

(h) Other action

There is good reason to believe that the steps proposed to be taken with respect to the directed give-up and the volume discount will substantially reduce the adverse consequences to the funds and their stockholders of using fund brokerage as extra compensation for selling fund shares. It is possible, however, that additional steps may be necessary to deal with these problems. For example, the abolition of customer-directed give-ups and the introduction of a volume discount in exchange transactions may lead some mutual fund managers who wish to reward a number of brokers for services unrelated to the handling of brokerage orders to fragment the funds' orders among many transmitting or executing brokers. The Commission believes that such fragmentation normally would be inconsistent with the legal duty of fund managers to seek the best execution for their clients. The Commission will exercise its jurisdiction to enforce this basic fiduciary duty.

If experience shows that the steps outlined above have failed to curb the adverse consequences to investors of the link between the mutual funds' share-selling activities and their portfolio brokerage business, another alternative, which the Commission is not yet prepared to recommend, will have to be considered. This would be to prohibit broker-dealers from acting as brokers for or sharing in the brokerage commissions paid by funds whose shares they sell. Although indirect and subtle reciprocal arrangements may nevertheless arise,[117] such a divorce of share selling from portfolio brokerage may be the most effective way to curb the use of fund brokerage in the competition for sales of fund shares. However, such an approach would limit the number of brokerage firms from which smaller funds or complexes could acquire supplementary investment advice and other nonsales services. To some extent it would also limit fund managers in their choice of broker-dealers for fund portfolio transactions. This might affect the funds' portfolio transactions since cases could arise in which the dealers who had chosen to continue to retail fund shares were best able to handle particular transactions. Accordingly, the Commission will defer consideration of this alternative until it has had an opportunity to evaluate the effects of the steps it now proposes to take.

The Committee is also studying the dollars and cents effects of the SEC proposals. Customer directed give-ups on member firm transactions have not been measured precisely, but those paid by check at the direction of mutual funds only were reported by participating member firms in the 1965 Income and Expense reports. The total reported as paid out by primary brokers to other firms which had performed no direct physical work on order transmission, execution or clearance, was about 2% of total NYSE commission business done by member firms. While this figure may seem small in relation to the amount of attention focused by the SEC on give-ups, it is important beyond its size because of its distribution among member firms. The impact of a prohibition of customer directed give-ups would vary greatly among firms and even among groups of firms.

Current opinion of the Committee

The SEC's focus to date, although apparently based on a concern with mutual fund practices, goes much further. The Commission recommends the prohibition of any institutional customer - as well as any individual customer (with two exceptions) - directing a broker with whom an order is placed to give-up part of the order to other brokers or to pay part of the commission on the order to other brokers.

The Special Committee on Member Firm Costs and Revenues, on the other hand, approaches the subject of give-ups from quite a different direction. It sees a need for documenting the propriety of the present commission schedule and also is concerned for the give-up oriented practices of the regional exchanges related to all customers. It is the latter practices which have eroded the central market. Since reading the long awaited report on mutual funds, the Committee on Costs and Revenues has reconsidered its past thinking on give-ups at length. It has also had the benefit of the fresh perspective provided by the four Exchange Governors added to the Committee in November. Each of these men is a senior proprietor of his member firm.

The Committee strongly believes that the lead broker concept is essential for maintaining a strong central market for block orders. A single broker or firm can most efficiently direct the efforts of others in the purchase or sale of a block. A lead broker often secures the cooperation of the specialist who may help in the execution of the block order by buying or selling, either as broker or for his own account, or by telling the lead broker of buying or selling interest on the part of others. A customer's alternative is to split the block into pieces given to different brokers. A succession of different brokers entering the trading crowd representing parts of the same order tends to work against the interest of the customer. It also may put the specialist in a position where his ability to keep a fair and orderly market is taxed. He may sense that a large buying or selling

program is underway, and not knowing its extent cannot be of maximum help in executing it.

The Committee not only strongly believes in the lead broker concept, but also in the right of both individual and institutional customers to place their orders with the brokers of their choice and to direct - by means of the lead broker - the composition of any group of brokers which they may wish to participate in the handling and processing of an order. There are numerous valid reasons other than rewarding firms for mutual fund sales why a customer might desire different phases of its order handled by different firms:

. . . One broker may be locally convenient for quotations and transmission of orders.

. . . Other brokers may have made a major contribution to investment decisions through furnishing research and economic information and advice.

. . . A customer may believe that a particular floor broker has the knowledge and skill to handle a certain order unusually well.

. . . The aid of a block placement department may be wanted.

. . . Billing, settlement, delivery may be decided for geographical or financial reasons.

. . . Personal confidence or personal inclination of a customer may by itself be transcending.

. . . Banks may wish to do business with several securities firms which have checking or loan accounts with them.

. . . Insurance companies may wish to give securities business to several brokers whose insurance policies they issue.

. . . Landlords may prefer to have their securities transactions handled by several tenant brokers.

. . . A tax consultant, investment adviser, or bank may be handling the affairs of customers whose brokerage accounts are carried by a number of different member firms. In such instances, it may be most efficient for

the agent to give the orders for a number of accounts to a single broker with instructions to give up on the Exchange floor the names of the firms carrying the accounts of the individual customers.

The Committee insists specifically also that the right should be retained for an institution to give an order for the account of a correspondent broker directly to the New York office of the clearing firm which acts as the correspondent's agent. And in cases where costs and services are the same, it would be unrealistic to prohibit the exercise of friendship, and uneconomic to restrain normal business reciprocity when such customers wish to have several firms participate in the handling of an order.

Give-ups by check

In studying give-up problems, the Committee differentiates between give-ups where some actual work is done on the handling of an order and give-ups by check. Giving up by check, they realize, not only is used in connection with mutual fund sales but also may compensate a broker who assisted prior to the placement of a particular order with research and economic information, quotations, etc. Brokers are also rewarded for such research services by being given orders to handle. Reciprocity - giving business to those who give you business when prices and services are competitive - the Committee also recognizes as a traditional and accepted way of American business life. Checks are being given up for reciprocal reasons, but much reciprocity by banks, insurance companies, mutual funds and others is also expressed to securities brokers through the actual placement of orders.

The Committee feels that it is not within the province of the Exchange to disrupt the business methods of other sections of the securities industry. It would appear more appropriate for the SEC to act, if necessary, on directed give-ups by mutual funds pursuant to the Investment Company Act of 1940. The SEC should not force NYSE members to restrain customers where the SEC itself has regulatory authority over those customers. It would be especially unfair for the Exchange to change the practices of mutual funds and other institutions when these customer groups have no representation in the Exchange rule-making process. Furthermore, no case has been presented by the SEC for extending its recommendations on prohibition of give-ups to types of institutions other than mutual funds.

The Exchange has a responsibility, however, to answer the questions raised by the SEC as to the propriety of the commission rate structure itself. The widespread practice of giving half or more of the commission on large orders to brokers who perform no identifiable

work on the order has been cited by the SEC as raising the question of whether commissions on such transactions are reasonable. The SEC has formally asked the Exchange to consider changing its commission schedule, and the SEC clearly has the authority under a Section 19(b) proceeding to do so itself if the Exchange does not.

The widespread practices of give-up by check which have developed in recent years are a serious deterrent to effective documentation of the reasonableness of the Exchange's minimum commission charges, the Committee recognizes. Such documentation is necessary to answer the SEC's requests to the Exchange concerning present commission schedules, for defense in a 19(b) hearing, or to support any future change in commissions. Yet, Exchange action by itself to limit or eliminate give-ups by check would probably result in driving orders to other exchanges. Consequently, the Committee strongly agrees with the SEC that any action taken in modifying current practices of give-up by check must be industry-wide at SEC direction.

The Committee is also strongly of the opinion that the increasing tendency to divert trades to regional exchanges to take advantage of easier commission splitting rules poses a serious threat to successful enforcement of this Exchange's minimum commission law. Each new step in that direction may have seemed logical and profitable at the time it was taken, but the cumulative effect has been to encourage evasion of the minimum commission principle and to weaken the economic strength of the Exchange Community. The long-term effect may well be a serious weakening of the central market to the detriment of both member firms and public customers.

The Committee, therefore, reasons that the Exchange Community and its customers would benefit if compensation for all services were expressed through opportunities to participate in the work of an order rather than in the give-up by check. The Committee is inclined to recommend that the Board of Governors not oppose the SEC requiring a rule for all exchanges that commissions be shared only between members or member organizations who perform some function in connection with a particular order or a part of it - origination, transmittal, execution, clearing, carrying account, etc. In addition, it feels that some limitation on the percentage of commission which can be given up would be appropriate.

The give-up by check would be eliminated by such a rule. Non-members eligible for splits of commissions on regional exchanges, in effect, would be limited to such sharing of commissions on orders they originate, rather than on any orders as at present.

The Committee realizes that this proposal does not offer a complete answer to the SEC's concern with mutual fund direction of give-ups of all kinds; it is instead one approach to an Exchange problem. It would, however, help to keep sharing of commissions more closely aligned and identified with services received.

A large group of member firms rely on customer directed give-ups for an important part of their income. If present give-up practices are in any way modified, the Committee recognizes that it must then face the question of whether the Exchange's commission rates need to be restructured to provide member firms with an equitable income on their commission business. Hopefully, such a restructuring would give all member firms a reasonable income from a normal mix of commission business, and lessen their dependence on customer directed give-ups from large orders. Possible methods of doing so will be the subject of future discussion papers for the membership.

Sincerely,

G. Keith Funston

SPECIAL COMMITTEE ON MEMBER FIRM COSTS AND REVENUES

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G. Keith Funston (ex officio)

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2156

3053

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FILED
JUN 11 1971
SECURITIES & EXCHANGE COMMISSION

In the Matter of

ARTHUR LIPPER CORPORATION
ARTHUR LIPPER III

(8-13182)

INITIAL DECISION

Washington, D.C.
June 11, 1971

Warren E. Blair
Chief Hearing Examiner

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2156

L. 2854

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of ARTHUR LIPPER CORPORATION ARTHUR LIPPER III (8-13182)	INITIAL DECISION

APPEARANCES: Kevin Thomas Duffy, Stanley Sporkin, Marvin E. Jacob, Robert M. Laprade, Joanne Leveque, and Robert L. Anthony, for the Division of Trading and Markets of the Commission.

John A. Dudley, of Sullivan & Worcester, and Howard S. Klotz, for Arthur Lipper Corporation and Arthur Lipper III.

BEFORE: Warren E. Blair, Chief Hearing Examiner

These proceedings were instituted by an order of the Commission dated September 18, 1969 ("Order") pursuant to Sections 15(b), 15A, and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether Arthur Lipper Corporation ("registrant"), a broker-dealer registered under the Exchange Act, and Arthur Lipper III ("Lipper") wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as alleged by the Division of Trading and Markets ("Division") and whether remedial action under the Exchange Act is necessary.

In substance, the Division's allegations are that during the period from about July 10, 1967 to on or about August 5, 1968, respondents committed the alleged violations by entering into fraudulent arrangements with the management of certain investment companies controlled by IOS, Ltd. (S.A.) ("IOS"), 1/ and that respondents' activities pursuant to those arrangements had the effect of benefiting an IOS

1/ By order of the Commission dated July 7, 1970 these proceedings were consolidated with those instituted against IOS, Ltd. (S.A.), et al., A.P. File No. 3-2157 (September 18, 1969). Hearings in the consolidated proceedings were held, but because offers of settlement by the IOS respondents were to be submitted for Commission consideration after the close of the hearings, post-hearing procedures with respect to IOS respondents have been held in abeyance. In March, 1971 the Commission issued its Findings and Order imposing remedial sanctions against Bernard Cornfeld, Edward M. Cowett, Raymond Grant, and Robert F. Sutner, four of six IOS respondents. Securities Exchange Act Release No. 9094 (March 1, 1971). On March 18, 1971 the hearing was reopened as to the remaining two IOS respondents, IOS, Ltd. (S.A.) and Investors Planning Corporation. Findings herein are made only as to Arthur Lipper Corporation and Arthur Lipper III and are not binding on the respondents named in IOS, Ltd. (S.A.), et al., supra.

3055

controlled broker-dealer to the detriment and disadvantage of the affected IOS controlled investment companies. Allegedly, FOF Proprietary Funds, Ltd. ("FOF Prop."), IIT, a foreign investment trust ("IIT"), and Regent Fund, Ltd., a Canadian investment fund, were investment companies whose managers were owned or controlled by IOS. Investors Planning Corporation ("IPC"), a broker-dealer registered under the Exchange Act, was also under IOS control during the period in question. Under the alleged arrangements with managers of the mentioned investment companies, provision was made for the payment of monies to IPC out of charges and commissions earned by respondents on over-the-counter transactions executed by them for the accounts of the investment companies.

The answer filed by respondents denied the alleged violations, and admitted that give-ups 2/ were paid by registrant to IPC out of commissions earned by registrant on over-the-counter transactions executed for the accounts of the named investment companies but denied any duty to disclose those give-ups to shareholders of those investment companies. Registrant and Lipper appeared and were represented by counsel throughout the hearing.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by parties to these proceedings.

2/ A "give-up" is in effect a splitting of the commission received by the executing broker with another broker designated by the customer to receive a certain portion of that commission.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

Respondents

Registrant, located in New York City, has been registered as a broker-dealer under the Exchange Act since March 31, 1967, and is a member of the National Association of Securities Dealers, Inc., ("NASD") and of the New York Stock Exchange ("NYSE"), American Stock Exchange, and other national securities exchanges registered under the Exchange Act. Lipper has been president, a director, and a controlling stockholder of registrant since its formation.

IOS, Ltd. (S.A.)

IOS, a Panama corporation having its principal office in Geneva, Switzerland, is a holding company which controlled numerous subsidiaries during the period in question. Among those subsidiaries were IPC; FOF Prop.; IIT Management Co. (S.A.) which managed IIT; Regent Fund Advisers (1963) Ltd., and Canadian Fund Management Company, Limited, which then managed Regent Fund; and Fund of Funds, Ltd. ("FOF"), a Canadian open-end investment company which as of December 31, 1967 owned all of the outstanding shares of and had over $375,000,000 invested in FOF Prop. Bernard Cornfeld ("Cornfeld") was president and Edward Cowett ("Cowett") executive vice-president of IOS during the period in question; each also was an IOS director and

held various management positions in IOS subsidiaries. 3558

From June, 1960 until June, 1967, IOS was registered as a broker-dealer under the Exchange Act. Its registration was terminated by a withdrawal thereof pursuant to an offer of settlement accepted by the Commission in connection with proceedings instituted against IOS and other respondents in 1966 (hereafter referred to as "the 1966 Proceedings"). 3/

In 1965 IOS acquired the assets of a large established broker-dealer in the United States and placed those assets in IPC, intending that IPC be the IOS subsidiary which would sell securities in the United States market. IPC became registered as a broker-dealer in June, 1965 and became a member of NASD. However, as part of the settlement of the 1966 Proceedings, IOS was required to dispose of its entire interest in IPC.

Initially IOS assumed that IPC would operate at a loss for two or three years, but when IOS became aware in December, 1966 that a settlement of the 1966 Proceedings would entail divestment of its IPC interest, IOS took immediate steps to improve the profitability of IPC's operations in order to present a potential buyer of IPC with a picture of a sound business. IOS actions to that end included changes in IPC's management personnel and generation of income for IPC by means of IOS directed give-ups paid to IPC by broker-dealers executing portfolio transactions for IOS controlled investment companies.

Early in 1967, Cowett gave his attention to a further problem that the contemplated settlement of the 1966 Proceedings created for IOS.

3/ IOS, Ltd. (S.A.) d/b/a Investors Overseas Services, Securities Exchange Act Release No. 8083 (May 23, 1967).

Under the terms of the offered settlement, portfolio transactions for IOS and its affiliated funds would be permitted in the United States if their orders were placed with an independent non-affiliated entity outside of the United States, but neither IOS nor any of its affiliated funds would be allowed to place orders directly with securities brokers located in the United States. Cowett therefore approached Lipper, then a partner in the brokerage firm of Zuckerman, Smith & Co., and asked whether his firm would be interested in opening offices in London, England and Geneva, Switzerland for the purpose of being the central coordinating agent for handling the flow of IOS brokerage transactions. Other partners of Zuckerman, Smith & Co. declined the proposal but were willing to let the firm act as clearing agent for Lipper if he formed his own company. Lipper reported these facts to Cowett and at the same time indicated his willingness to undertake to create the system that IOS required. The upshot of these conversations was that Lipper formed registrant and opened offices in London and Geneva upon Cowett's assurance that IOS sources would generate sufficient business "to cover the kind of investment that was being entailed."

Commencing in April, 1967 an elaborate communications network linking registrant's New York office with its foreign offices was utilized for the transmission of orders and information relating to IOS fund portfolio transactions and for the exchange of other information of interest between IOS and registrant. Additionally, registrant's facilities were used during market trading hours by IOS

personnel in Geneva to obtain quotes, research information, and other securities information from sources in the securities business in the United States.

Violations by Respondents

As indicated, Lipper expected that from registrant's inception it would be favored with IOS fund-related business as compensation for the risk he assumed in launching the firm. And Lipper clearly realized that about 50% of the commissions registrant generated from IOS business would have to be paid by registrant to other brokers in accordance with IOS directed "give-ups."

Registrant's commission charges on over-the-counter transactions during the period in question were the same as those listed under the NYSE minimum-rate schedule, and, as Lipper anticipated, directions were received from Cowett regarding the give-ups to be paid on those commissions. By letter dated June 29, 1967 Cowett, as president of FOF Prop., directed registrant to give to IPC "the maximum give-up (50%)" on commissions earned on over-the-counter transactions for the account of FOF Prop. That letter was followed by a letter dated July 11, 1967 containing similar instructions to registrant, but relating to over-the-counter transactions for the account of IIT. A third letter dated March 15, 1968 confirmed an earlier request that registrant pay IPC similar give-ups on the over-the-counter transactions effected on behalf of Regent Fund, Ltd. Each of the last two letters

was also signed by Cowett, the former as a representative of IIT Management Co., the latter as vice-president of Canadian Fund Management Company, Limited.

In keeping with Cowett's directions, acceded to by Lipper without question, registrant remitted approximately $1,275,000 to IPC during the period from July 10, 1967 to August 5, 1968, that amount representing about 50% of the Commissions paid to registrant during that period by FOF Prop., IIT, and Regent Fund on over-the-counter transactions.[4/] However, because IPC required cash in order to meet a contract deadline of September 30, 1968, Cowett sought an additional give-up of $300,000 from registrant. In a letter dated August 14, 1968 signed by Cowett as president of FOF Prop., reference was made to the previous give-up instructions and registrant was requested:

> Over and above such regular 50% "give-up," we herewith request that you make the following "give-up" payments to Investors Planning Corporation of America:
>
> 1. $175,000 on/before August 30, 1968
> 2. $175,000 on/before September 30, 1968.

Lipper demurred to the size of the request, telling Cowett that registrant should not be required to pay out more than another $175,000. The lower amount suggested by Lipper was eventually sent to IPC on August 28, 1968, bringing registrant's give-ups to IPC on over-the-counter transactions for FOF Prop., IIT, and Regent Fund to slightly more than

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4/ Registrant's records reflect give-ups to IPC of $950,821 on FOF Prop. transactions, $312,175 on IIT's, and $12,521 on Regent Fund's, out of respective gross commissions of $1,974,064, $636,423, and $28,670.

$1,450,000. No benefits were received by those funds as a result of registrant's give-ups and no service appears to have been rendered by IPC as consideration for the $1,450,000.

It is clear that adequate disclosure of the arrangements existing between Lipper and Cowett for the payments of give-ups by registrant to IPC was never made to FOF shareholders who had a material interest in the fortunes of FOF Prop., nor made to shareholders of IIT or Regent Fund. It is likewise clear that those shareholders were not told that IPC was providing neither benefits nor services to the funds in exchange for 50% of the commissions the funds paid to registrant on their over-the-counter transactions. It further appears that no such disclosures were made to the board of directors of Regent Fund or IIT, but that discussions regarding Cowett's arrangements with Lipper took place at FOF board meetings. During those discussions one of the directors, then also Lipper's attorney, advised the FOF board that in his opinion "this mode of operation was appropriate, since he did not know of any legal way the Fund could get any benefit from these commissions,"[5/] and also that FOF "had no alternative but to pay the minimum commission of the New York Stock Exchange."[6/]

The substantial benefits enjoyed by IPC under the give-up arrangements worked out between Cowett and Lipper can be regarded only as obtained at a corresponding and unjustifiable expense to the

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5/ Transcript, 594.

6/ Id., 1071.

shareholders of FOF, IIT, and Regent Fund.[7/] As observed by the

Commission in December 1966:

> A directed give-up of a portion of the commission charged for handling a transaction for a fund in the over-the-counter market would be a patent waste of investment company assets. Since the over-the-counter market in both listed and unlisted securities is a negotiated market, which is not governed by fixed prices or minimum commission rate schedules, any willingness of the executing broker or dealer to allow his customer to direct a give-up of a portion of his commission or mark-up to dealers in fund shares in and of itself shows that a lower price or commission could have been negotiated. 8/

Obviously the crux of the arrangement entailed an understanding between Cowett and Lipper regarding commissions to be charged to the funds for effecting their over-the-counter portfolio transactions. Such commissions of necessity had to provide Lipper with adequate compensation for his risk and services, but at the same time had to be sufficient in amount to fulfill the objective Cowett sought for IPC.

It appears from the practice adopted by registrant that the commissions Cowett and Lipper found most nearly meeting their requirements were at rates equal to the minimum rates the NYSE required on

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7/ "In an over-the-counter transaction, those who perform no service should not participate in commissions or profits and there should be no give-up arrangements with them. Obviously, if a negotiated commission or price allows for a give-up of a portion of the commission or profit, a better execution for the investment company could have been negotiated if no give-up had been involved." Robert S. Driscoll, Procedures of Affiliated Fund and American Business Shares in Buying and Selling Portfolio Securities, 14 (1965).

8/ Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966), 178.

NYSE transactions. Clear evidence of how well those rates fit their needs is also found in the $175,000 settlement of Cowett's additional $300,000 give-up demand which Lipper initially resisted in August, 1968 as being excessive. That settlement indicates a mutual realization that registrant's previously retained 50% of the commissions represented a reasonable charge for registrant's services during that period.

3064

But the willingness of Lipper to give-up 50% of registrant's commissions to IPC makes manifest that Cowett was disinterested in the welfare of IOS funds and failed to discharge fiduciary responsibilities owed to them. As president of FOF Prop., and as a vice-president of the companies managing IIT and Regent Fund, Cowett was cloaked with the authority to control and direct the execution of portfolio transactions of those funds. He thereby became a fiduciary in relationship to those funds charged with responsibility for obtaining executions of their portfolio transactions at the least possible cost. 9/ Since Lipper was satisfied to have registrant retain only 50% of the commissions paid by the funds on their over-the-counter transactions, Cowett could and should have negotiated a 50% reduction in those commissions rather than directing a 50% give-up to IPC. In short, by preferring to bolster IPC's balance sheet for the eventual profit of IOS, 10/ Cowett abused the fiduciary positions reposed in

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9/ Provident Management Corporation, Securities Exchange Act Release No. 9028 (December 1, 1970); Consumer-Investor Planning Corp., Securities Exchange Act Release No. 8542 (February 20, 1969).

10/ In April, 1969 Equity Funding Corporation paid IOS $9,400,000 for assets of IPC which had been acquired by IOS in April, 1965 upon payment of $1,783,424 cash plus approximately 20% of IPC's outstanding stock.

him by the funds.

Lipper knew in 1967 when registrant received give-up instructions that Cowett was an officer and director of the IOS related funds for whom registrant effected transactions and a senior executive of the management companies of those funds. He was aware, too, that Cowett was a senior executive and director of IOS. Knowing these relationships, Lipper also knew or should have known that Cowett had an obligation to obtain registrant's services for the IOS funds he represented at the least possible cost to them. Under the circumstances, registrant's and Lipper's acquiescence and participation in give-up arrangements which drained from and wasted nearly $1,500,000 of the assets of the IOS related funds constituted participation with Cowett in a scheme to defraud and in a practice which operated as a fraud and deceit upon FOF, FOF Prop., IIT, and Regent Fund, and their shareholders. 11/

Additionally, respondents' participation in Cowett's scheme was in derogation of registrant's fiduciary responsibility to deal fairly with its IOS fund customers. Those funds and not IPC should have received the benefit of respondents' willingness to execute the funds' transactions at 50% of the commissions actually charged the funds. Nor can respondents be heard to say that the funds were aware of the arrangement with Cowett because he was their representative.

11/ Cf. Provident Management Corporation, supra.

The knowledge of Cowett, the architect of the scheme in question, cannot be imputed to the targets of the fraud. As noted by the Court in Schoenbaum v. Firstbrook: 12/

> However, as in other situations governed by agency principles, knowledge of the corporation's officers and agents is not imputed to it when there is a conflict between the interests of the officers and agents and the interests of the corporate principal. [citations omitted]

Similarly, it cannot be said that Cowett's disclosures to the FOF board of directors concerning the give-up arrangement negated the existence of the fraud involved in that arrangement. Again, as stated in the Schoenbaum case:

> [A] corporation may be defrauded in a stock transaction even when all of its directors know all of the material facts, if the conflict between the interests of one or more of the directors and the interests of the corporation prevents effective transmission of material information to the corporation in violation of Rule 10b-5(2). [footnote omitted] 13/

Here, the record indicates that the disclosures at the FOF board meeting were accompanied by an opinion of the FOF director, who was also Lipper's counsel, that there was no legal way that FOF could obtain any benefit from the commissions being paid to registrant. The expression of that opinion under the circumstances undoubtedly chilled the likelihood of meaningful discussion regarding the give-up arrangement or the possibility of negotiating a lower commission rate with Lipper.

12/ 405 F.2d 200, 211 (2d Cir. 1968), en banc 405 F.2d 215 (2d Cir. 1968), cert. denied 395 U.S. 906 (1969).

13/ Id.

Accordingly, it is concluded that registrant and Lipper wilfully violated and wilfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondents' argument that registrant could not have charged the IOS related funds a 50% lower commission rate cannot be accepted. Central to that position is respondents' assertion that under then prevailing rules of the NYSE, registrant was required to charge the minimum NYSE standard commission on over-the-counter transactions. The record, however, does not support respondents, but rather the contrary.

It is quite true that as a NYSE member registrant was required to abide by the constitution and rules of the NYSE, and that it was the practice of NYSE members to charge the minimum NYSE standard commission on over-the-counter transactions. But neither NYSE requirements nor the practice of its members precluded a reduction of commissions on such transactions if the reduction did not in reality amount to an illegal rebate on NYSE business.14/ Indeed, Robert Bishop,

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14/ During the period in question, Article XV, Section 1 of the NYSE Constitution provided:

> Sec. 1 Commissions shall be charged and collected upon the execution of all orders for the purchase or sale for the account of members or allied members or of parties not members or allied members of the Exchange, of securities admitted to dealings upon the Exchange and these commissions shall be at rates not less than the rates in this Article prescribed; and shall be net and free from any rebate, return, discount or allowance made in any shape or manner, or by any method or arrangement direct or indirect. No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a rule adopted by the Board of Governors, shall be given, paid or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member or allied member of the Exchange or member firm or member corporation.

NYSE vice-president in charge of the Department of Member Firms, testified that NYSE minimum commissions applied to NYSE trades and not to over-the-counter transactions, and further that the NYSE did not feel it had authority to establish rates in the over-the-counter market.

The only apparent concern of the NYSE with respect to commissions charged by its members on over-the-counter trades was whether such commissions were used as a vehicle for providing illegal rebates on commissions charged on NYSE transactions. A member firm charging less than NYSE minimum rates on over-the-counter trades would be called upon by the NYSE to demonstrate that the lower charges did not involve an indirect rebate, but the NYSE could be satisfied with a showing that the reduced commission was sufficient to cover the firm's cost of effecting the over-the-counter transaction.

Respondents seize upon this limited interest of the NYSE in over-the-counter commissions charged by its members as evidence that registrant was required to charge the IOS funds the minimum NYSE rates on their over-the-counter transactions, and offer the evidence that NYSE members customarily used those rates as further support of that position. Clearly the argument is to no avail, for the limited interest of the NYSE in this area cannot be so readily transformed into a prohibition against negotiation of commission rates on over-the-counter business. The fact that member firms

3069

undoubtedly found it more expedient and even more profitable to charge NYSE rates on over-the-counter business rather than attempting to justify a lower rate upon challenge by the NYSE can in no wise excuse respondents from giving the IOS funds the benefit of the 50% reduction which Lipper clearly recognized would still leave registrant with a very profitable operation. That Lipper realized registrant's over-the-counter rates could be reduced may also be inferred from the fact that in 1969 registrant began to charge all of its customers 6 cents per share on over-the-counter trades, far less than the NYSE rate, and did so without suffering more than the expected challenge from the NYSE to demonstrate that the 6 cent charge was sufficient to cover registrant's costs. Moreover, since the NYSE rules were the same during the period in question as they were in 1969, it would appear that the failure to afford the IOS funds a reduction in commissions must be attributed to respondents' desire to accommodate Cowett in his objectives and not to any proscription to be found in the NYSE rules.

No comfort can be obtained by respondents from the absence in 1967 of objection by the NYSE to give-ups shared with other broker-dealers. The attitude of the NYSE toward then existing give-up practices reflected an industry-oriented approach that cannot be considered objective in relation to the

interests of the customers of member firms.[15/] In any event, the acceptance by the NYSE of the practice of over-the-counter give-ups cannot establish the legality of the practice.[16/] On the other hand, as argued by respondents, statements of the Commission staff on the subject of give-ups are not to be accorded the weight of judicial or administrative decisions. However, such statements are relevant in considering the public interest after a finding that respondents have committed the charged violations.

Another facet of respondents' defense suggests that the give-ups here involved have the sanction of the Commission as expressed in the release that accompanied the Commission's proposed Rule 10b-10.[17/] Whatever merit there might be in respondents' views that

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15/ For example, Division Exhibit 78, entitled Across the President's Desk, A Periodic Report to the Exchange Community from G. Keith Funston, Issue #13, February 1, 1967, is devoted to the first report of the NYSE Special Committee on Member Firm Costs and Revenues and covers problems relating to give-ups. In the course of that report the Committee's approach to the problems under consideration is set forth as follows:

> In considering possible solutions of these problems let it be emphasized that at all times the Committee has been guided by two basic concepts - the promotion of the central market for listed securities on this Exchange, and the economic health of NYSE members and member firms - both of which in the Committee's view are essential to maintaining and improving investment service to the public.

16/ Chasins v. Smith, Barney & Co., Inc., CCH Fed. Sec. L. Rep. ¶92,962, at 90,557 (2d Cir. 1971).

17/ Securities Exchange Act Release No. 8239 (January 26, 1968).

3070

the release in question contradicts the Division's assertion that give-ups in the over-the-counter market have long been recognized as illegal, the release does not sanction the conduct of respondents. The release does, however, call attention to the fact that the proposed Rule 10b-10 "reflects a duty on the part of mutual fund managers as fiduciaries not to use commissions paid by their beneficiaries for the benefit of the fiduciary when practices, procedures, and rules of the markets in which fiduciaries act permit their beneficiaries to receive tangible benefits in the form of reduction of the charges now borne by them." 18/ While registrant may not have been in a position, as contended by respondents, to cause IOS to reduce the advisory fees charged the IOS related funds by the amount of the give-ups paid to IPC, a procedure contemplated under the proposed Rule 10b-10, there was nothing to prevent respondents from refusing to participate in Cowett's scheme, thereby honoring registrant's obligation to deal fairly with its customers.

Were this a case where a duly authorized representative of the IOS related funds had negotiated with Lipper, respondents' view that they had no obligation to shareholders of those funds to disclose the arrangements entered into with Cowett would be apposite. But, as indicated, respondents knew or should have known that the conflicts of interests represented by Cowett precluded the possibility that they were dealing with a person whom they now insist they regarded as "a

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18/ Id. at 8-9.

duly authorized officer and/or director of each of the IOS related funds." Under the circumstances, respondents' reliance upon Cowett's official capacities with the IOS funds, without consideration of the conflicts represented by his other known official positions with IOS, was wholly unwarranted. Without disclosure to the boards of directors of the IOS funds, or, in the alternative, to the shareholders of those funds, registrant cannot be said to have obtained the requisite informed consent to arrangements adverse to the interests of its fund customers. 19/

There is merit to respondents' position that the Division has not shown that registrant should have reduced the cost borne by the IOS fundsby effecting transactions on a principal instead of an agency basis. The choice of whether to act as principal or agent in effecting transactions involves many conflicting considerations, not the least of which are the disclosure problems that respondents point out were highlighted in the Arleen W. Hughes case. 20/ Except under unusual circumstances, that choice should be left to the business judgment of the broker-dealer without fear that hindsight may develop reason to criticize his judgment in that respect. Here, respondents were not required to consider acting as a principal as an appropriate alternative to registrant's agency relationship with the IOS funds,

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19/ Arleen W. Hughes, 27 SEC 629, 634-39 (1948), aff'd sub nom., Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949).

20/ Id.

but respondents were required to refrain from participating in Cowett's scheme to defraud registrant's customers.

Respondents' attack upon the Division's citation of Commission releases Delaware Management Company, Inc., Consumer-Investor Planning Corporation, Dishy, Easton & Co., Hertz, Warner & Co., and Provident Management Corp.,[21/] cannot be sustained. While those releases involved "consent orders" entered on the basis of offers of settlement, the views expressed by the Commission therein are certainly entitled to weight in the consideration of the issues in this matter. The argument that certain of the releases which followed earlier orders in the same matters by as much as nine months are no more than purported "rules" issued in violation of the requirements of the Administrative Procedure Act for rulemaking[22/] is not supported by logic or authority. In each instance that the Commission's order preceded its findings and opinion, the order specifically stated that definitive findings and an opinion would follow. Such statement must be construed as a reservation of the Commission's jurisdiction over the matter for that limited purpose and is a complete answer to respondents' contention that the order terminated the adjudicatory process. Further, it appears that the supplementation of the earlier order is in keeping with the principle that the basis of an agency decision should be clearly stated on the record.[23/]

21/ Respectively, Securities Exchange Act Release Nos. 8128 (1967), 8542 (1969), 8702 (1969), 8874 (1970), and 9028 (1970).

22/ 5 U.S.C. 553.

23/ Cf. Medical Com. for Human Rts. v. SEC, 432 F.2d 659 (D.C. Cir. 1970); Environmental Defense Fund, Inc. v. Hardin, 428 F.2d 1093 (D.C. Cir. 1970).

Respondents also assail the jurisdiction of the Commission, 3374 arguing that the Exchange Act does not have extra-territorial application with respect to the obligations owed by IOS to the IOS related funds, and that since IOS and the IOS funds were foreign corporations, their respective rights must be determined by application of appropriate foreign law, the provisions of which are not shown on the record. That argument is unconvincing in light of the fact that not only were the United States mails used to place Cowett's scheme in motion, but the very securities transactions that were required if the scheme were to bear fruit were effected on the United States over-the-counter markets. Where a scheme is one which is necessarily accomplished by use of the mails or interstate facilities within the United States, it seems clear that the remedial protections of the Exchange Act are properly invoked in the interests of maintaining and assuring the integrity of this nation's securities markets.[24/] Although this conclusion has the effect decried by respondents of extending the protective provisions of the Exchange Act to foreign corporations and their foreign shareholders, that benefit is merely incidental to the primary objective of carrying out the intent of the Exchange Act to prevent inequitable and unfair practices on the over-the-counter markets in the United States. Being remedial legislation, the Exchange Act must, under recognized principles of statutory interpretation, be given a liberal

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24/ SEC v. Gulf International Finance Corp., 223 F. Supp. 987, 995 (S.D. Fla. 1963).

construction, that which will best conform with the general purpose of the legislation.[25/] Further on the point, it has been long settled that "any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends."[26/]

Public Interest

Although the respondents' violations were serious and long continuing, it does not appear necessary in the public interest to impose the revocation and bar sanctions recommended by the Division. Taking into consideration the mitigating factors urged by the respondents as well as the offsetting aspects detailed by the Division, a suspension of registrant's right to effect transactions in the over-the-counter markets for a period of twelve months and, as to Lipper, a suspension from association with a broker or dealer for the same period are found to be appropriate.

Contrary to respondents' assertion, it does not appear that Lipper was sensitive regarding the overcharges registrant was making on the IOS funds' over-the-counter transactions, or, if he was, he did nothing to ameliorate that fraudulent practice until his own and registrant's financial success were assured. The picture that emerges

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25/ SEC v. Capital Gains Bureau, 375 U.S. 180, 195 (1963); SEC v. Joiner Corp., 320 U.S. 344, 350-51 (1943).

26/ United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945).

from the record is of a man intent on personal gain and willing to take the risk that the scheme by which he could reach his goal would not be found illegal. Mitigating that portrayal, however, is the established fact that the customer-directed give-up practice had become embedded in the financial community and had not been judicially determined to be illegal during the years of respondents' violations,[27/] and the fact that Lipper relied upon advice of counsel.

But unlike the circumstances in those cases cited by respondents where uncertainty of the law was a factor, or advice of counsel was relied upon, respondents acted in the face of published comment of the Commission and its staff which was extremely critical of customer-directed give-ups,[28/] and did so after having been informed by their counsel that the Commission staff was in disagreement with the advice of counsel.[29/] To so proceed, with knowledge that their conduct was

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27/ In Moses v. Burgin, 316 F. Supp. 31, 57 (D. Mass. 1970), the court noted:

> No court has yet decided, and this court finds it unnecessary to decide, whether the customer-directed give-ups for the benefit of broker-dealers which were both customary and widely practiced before December 5, 1968 were lawful or unlawful.

28/ Public Policy Implications, supra at 17, 169-88; 4 SEC, Special Study of Securities Markets (1963), 226-27; 5 Id., 171-73; Division Exhibit 47 - Irving Pollack, Letter, Re: Commission Rate Structure (July 18, 1966).

29/ Transcript, 1054-55.

likely to invite attention from the Commission staff and possible action by the Commission, makes respondents' pleas with respect to the state of the law and the advice of counsel far less appealing, and certainly not entitled to the weight accorded similar pleas found in respondents' cited cases.

As noted, other mitigating factors advanced by respondents, including the reduction in registrant's commission charges in 1969, the absence of concealment from regulatory authorities of the give-up arrangements, the likelihood that respondents' misconduct will not be repeated, and the publicity regarding these proceedings, have been carefully weighed. On balance, the indicated remedial action is found to be necessary in the public interest. 30/

Accordingly, IT IS ORDERED that Arthur Lipper Corporation be, and it hereby is, suspended for a period of twelve months from the effective date of this order from effecting transactions in over-the-counter markets, and that Arthur Lipper III be, and hereby is, suspended from association with a broker-dealer for a period of twelve months from the effective date of this order.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice.

30/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

3078

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Warren E. Blair
Warren E. Blair
Chief Hearing Examiner

Warren E. Blair

Washington, D.C.
June 11, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT of 1934
Rel. No. 11773 /October 24, 1975

Admin. Proc. File Nos.
3-2156 and 3-2157

In the Matters of

ARTHUR LIPPER CORPORATION
140 Broadway
New York, New York
(8-13182)

ARTHUR LIPPER, III

IOS, LTD. (S.A.)
Geneva, Switzerland

INVESTORS PLANNING CORPORATION
OF AMERICA
(now known as CIP, Inc.)
New York, New York
(8-12374)

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Recapture by Affiliate of Commissions on Investment Company Portfolio Transactions Through Give-Ups from and Reciprocal Arrangements with Unaffiliated Broker-Dealers

Receipt of Money in Connection with Investment Company Portfolio Transactions

Over-the-Counter Give-Ups

Conflict of Laws -- International Law

Where manager of unregistered off-shore investment companies selected to execute companies' over-the-counter portfolio transactions broker who paid portion of commissions on such business to manager's subsidiary, held, manager, aided and abetted by broker, violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder; and gravity of misconduct required that registration of broker be revoked and that manager be barred.

Where Securities Exchange Act's antifraud provisions were violated in connection with portfolio transactions of unregistered off-shore investment companies executed in the United States, and where the violators were registered broker-dealers, held, United States has jurisdiction to take remedial action.

Receipt by Affiliate of Compensation in Connection with Purchase and Sale of Investment Company Property

Deficient Investment Advisory Contract

Misstatements in Prospectuses, Proxy Material and Other Documents

Where registered broker-dealer who was mutual fund's principal underwriter and investment adviser procured for itself rebates of fund's brokerage commissions from unaffiliated brokers without rendering any brokerage services in return therefor, held, such broker-dealer and its unregistered corporate parent violated or aided and abetted violations of Securities Exchange Act's antifraud provisions and of Sections 17(e)(1), 15(a)(1), 20(a), and 34(b) of the Investment Company Act and also of Rule 20a-1 under the Investment Company Act.

APPEARANCES:

Allan F. Conwill, of Willkie, Farr & Gallagher, John A. Dudley, of Sullivan & Worcester, and Howard S. Klotz, for Arthur Lipper Corporation and Arthur Lipper, III.

Calvin H. Cobb, Jr., Robert M. Goolrick, Edmund B. Frost, and W. John Amerling, of Steptoe & Johnson, for IOS, Ltd. (S.A.) and Investors Planning Corporation of America.

Stanley Sporkin, Marvin E. Jacob, Robert M. LaPrade, Joanne Leveque and Robert L. Anthony, for the Division of Enforcement of the Commission.

I. INTRODUCTION

This case is about the once vast international financial complex controlled by IOS, Ltd. (S.A.) ("IOS"). 1/ More specifically, it is about IOS's handling of the large volume of brokerage business generated by the enormous pools of other people's money under its management and about the way in which IOS used that brokerage business to serve its own interests rather than those of the investors who had entrusted their savings to it. The transactions in question were executed in the over-the-counter market and on the New York Stock Exchange.

1/ The initials stand for Investors Overseas Services.

In 1967 and 1968, the period involved in this case, brokers executed all stock exchange orders at fixed rates. These rates varied with the price per share of the security. But the commission was calculated on a per share basis. The commission on an order for 10,000 shares of a given stock was exactly 100 times that on an order for 100 shares of the same stock. Brokers found it profitable and were eager to handle transactions for investment companies and other institutional customers because the cost of handling large orders did not increase proportionately with the commissions they were obligated to charge. This was so much the case that brokers were willing and anxious to execute large institutional orders for substantially less than the fixed minimum commission rate. Since the commission could not be reduced, brokers were willing, at the customer's direction, to pay over part of the commission to other brokers within the rules of the stock exchange. Thus, large institutional investors had substantial amounts of so-called "excess brokerage" (*i.e.*, that portion of the commission that the executing broker was willing to give up) at their disposal. 2/

II. THE ADMINISTRATIVE LAW JUDGE'S INITIAL DECISIONS

The administrative law judge before whom the hearings were held concluded that:

1. Brokers who executed transactions for, and who therefore received commissions from, members of the complex of mutual funds managed by IOS 3/ surrendered portions of those commissions to an IOS subsidiary kn[illegible] as Investors Planning Corporation of America ("IPC"). 4/ This was done at IOS's direction.

2/ In theory, only the minimum rate of commissions was fixed. Brokers were free to go higher if they wished. And, in fact, brokerage houses sometimes charged more than the minimum on small transactions or even refused to handle them at all. By and large, however, the minimum was also the maximum.

3/ A group of mutual funds under common management is called a "fund complex." *See* *Report of the S.E.C. on Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess., 45-47 (1966) [hereinafter cited as Public Policy]. *See also* Glazer, *A Study of Mutual Fund Complexes*, 119 U. Pa. L. Rev. 205 (1970).

4/ IOS owned eighty percent of the outstanding IPC stock. After the events dealt with in this opinion, IPC changed its name to CIP, Inc.

2. Neither IOS nor IPC 5/ rendered any brokerage services to the funds in whose commission disbursements they shared.

3. The money surrendered by the executing brokers to the IOS respondents belonged in equity and good conscience to the funds out of whose commissions it came. When the IOS respondents appropriated that money for themselves, they breached their fiduciary duties to the funds under their management. This breach of duty and the failure to disclose it to actual and prospective investors in those funds were in willful violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

4. Fund of America, Inc. ("FOA") was registered with us as an investment company under the Investment Company Act. When the IOS respondents took a portion of that fund's excess brokerage, they violated various provisions of the Investment Company Act.

5. The IOS respondents' violations were serious. It is in the public interest to bar IOS itself from association with a broker or dealer. But IPC's situation is different. It is no longer controlled by or affiliated with IOS. Since its wrongdoing stemmed from its former relationship to IOS, a nine-month suspension of IPC's broker-dealer registration is enough to satisfy the public interest.

6. Arthur Lipper Corporation ("Lipper Corp."), a New York City broker-dealer, and, during the relevant period, a New York Stock Exchange member firm and also a member firm of other domestic securities exchanges registered with this Commission under the Securities Exchange Act, was organized to handle the large brokerage business for IOS-managed funds. Substantial portions of the commissions received from such business were surrendered to IPC. Thus, the Lipper firm was a knowing participant in the IOS respondents' fraudulent scheme. And so was its founder, president and controlling stockholder, Arthur Lipper, III. Lipper and his firm 6/ willfully aided and abetted some of the IOS respondents' violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

7. It would be in the public interest to suspend the Lipper firm from effecting transactions in the over-the-counter market for twelve months. During that period, Lipper himself should be suspended from association with any broker or dealer.

5/ Hereinafter sometimes referred to collectively as "the IOS respondents."

6/ Hereinafter sometimes referred to collectively as "the Lipper respondents."

An independent review of the record leads us to agree with the administrative law judge's analysis. 7/ We are also in accord with his view that it is in the public interest to preclude IOS from associating itself with brokers or dealers in the future. But we see no need at this juncture for remedial action against IPC. And we also disagree with the administrative law judge about the nature of the sanctions against the Lipper respondents called for by the public interest. As to that, we agree with our staff that suspension is not enough and that the Lipper respondents ought to be barred from the securities business.

Our reasons for so holding are stated below.

III. THE IOS COMPLEX

During the 1950's and the 1960's, the basic trend in the American equity securities markets was upward. In those years, the American mutual fund industry grew dramatically. 8/ These developments led foreign investors to take a favorable view of American mutual funds, and facilitated the sale of their shares abroad.

IOS capitalized on this market. 9/ It did so by means of the so-called "off-shore fund." That involved the formation by IOS of investment companies in countries other than the United States. 10/ Those entities sold their shares outside the United States. But they invested the proceeds largely or wholly in United States securities, using our securities markets to do so. IOS created off-shore funds, managed them after their creation, and sold their shares in many countries.

During the period of concern to us here, IOS, a Panamanian corporation that maintained its principal offices in Switzerland, controlled IPC, a large New York City-based United States broker-

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7/ The respondents petitioned for review of the administrative law judge's decision. Our Division of Enforcement also sought review with respect to what it considers the gross inadequacy of the sanctions imposed on the Lipper respondents. After granting all of the petitions for review, we received briefs from all parties and heard oral argument.

8/ This theme was expounded at length in Public Policy.

9/ IOS's first idea was the fund holding company, The Fund of Funds ("FOF") formed for the purpose of investing in American mutual funds registered and regulated under the Investment Company Act and in publicly-held mutual fund management companies. See Public Policy 311-324. But by the time dealt with in this opinion the original concept had been broadened so that it included direct investment in the stocks and bonds of United States companies engaged in industry and trade.

10/ The name "off-shore" is said to reflect the fact that many of the funds were set up on the islands off the shores of the United States. Note, United States Taxation and Regulation of Off-Shore Mutual Funds, 83 Harv. L. Rev. 404, 405 n.10 (1969).

dealer registered as such under the Exchange Act. IPC had little or no general securities business. Its primary activity was the retail sale of mutual fund shares to Americans here in the United States. Like many other mutual fund retailers, IPC sold the public shares in many different mutual funds. But it had nothing whatever to do with the management of those funds.

IPC, however, was more than a mere retailer of shares in mutual funds that were managed by others. It also had its own "in-house" fund for which IPC acted as investment adviser and principal underwriter. This fund was FOA, a corporation organized under New York law. There was nothing "off-shore" about FOA. It was just another domestic mutual fund. Like hundreds of similar funds, it was subject to the Investment Company Act and registered with us under that statute as an open-end investment company.

IPC's domestic mutual fund retailing operation was much older than IOS. In April 1965, IOS bought a controlling interest in IPC's going (albeit then unprofitable) retail mutual fund business. 11/ After that, IOS naturally wanted to make IPC profitable. One way of doing this was to build up IPC's captive fund, FOA.

As a mere merchandiser of shares in mutual funds controlled by others, IPC could expect only the retail dealer's share of the sales charge plus some excess brokerage income funneled to it by the managers of the funds whose shares it was selling. But when IPC sold shares in FOA, it:

1. Kept the total sales charge since there was no unaffiliated wholesaler or principal underwriter with whom that charge had to be divided; 12/ and

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11/ IOS attributed the losses to IPC's "unimaginative" management. An IOS official testified that IPC was acquired because it "represented an opportunity for IOS to come into the United States market, building from a base of a reasonably large and well-established broker-dealer." IPC had a 5,000-man sales force at the time of its acquisition by IOS. It appears that this sales force consisted for the most part of what a study by the staff of our Office of Economic Research described as "armies of salesmen who are believed to be worthwhile even if they only sell themselves, their close friends, and their relatives." S.E.C. Staff Report On the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, p. A-49 (November 1972). See also id. at pp. A-63 - A-64 (referring to "legions of unproductive low-income salesmen").

12/ Mutual fund sales charges tended to cluster around the 8.5 percent level. Thus, when an investor wrote a check for a thousand dollars to pay for a purchase of "load" fund shares, only $915 of that sum actually went to the fund for investment. The other $85 was consumed by the sales charge, which went to those who made the sale. During the relevant period, it was usual for principal underwriters to retain two percent of the investor's total payment (or about 25 percent of the aggregate sales charge) for themselves. The balance went to the retail dealers and the salesmen who did the actual selling. Public Policy 207-209.

2. Enhanced its advisory fee income because the sale of new shares increased the volume of assets on which the fee paid to IPC by FOA was based. 13/

So IOS made FOA grow. 14/ It did that in two ways. First, it caused IPC's sales force to push FOA and to deemphasize what had theretofore been that sales force's primary pursuit, the sale of shares in mutual funds unaffiliated with IPC. Second, IOS put money from one of its own off-shore funds into FOA. IOS's foreign mutual fund holding company, FOF, 15/ bought into FOA in a big way. From July 1965 to August 1966, FOF invested approximately $22 million in FOA. By mid-1966, FOF owned about 46 percent of FOA's outstanding shares. 16/

FOF's investment in FOA was a highly-remunerative proposition for IOS. The benefits to FOF itself or its shareholders were more obscure, to say the least. By having one of its funds, FOF, invest in FOA, another IOS-managed fund, IOS:

1. Collected a sales charge on a sales charge -- because the investor who bought FOF shares and who paid a sales charge to IOS at that time also bore the burden of the sales charge later paid by FOF to IPC (but inuring, of course, to the benefit of IPC's parent, IOS) when FOF purchased FOA shares from IPC, the exclusive distributor of those shares; 17/ and

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13/ Over the long-run, this was much more important than sales charge revenues. Generally, the advisory fees that the adviser-underwriters receive for their managerial services are based on the size of the asset pools under management. Since the size of a mutual fund does not fluctuate nearly as much as the sale of new shares, the advisory fee provides a stable source of income.

14/ FOA had only about $5 million in assets when IOS came into the picture. A year and a half later (on November 30, 1966) FOA's assets were around $44 million.

15/ *See* n. 9 on p. 5, *supra*.

16/ Public Policy-313, Table VIII-1. The record shows that in January 1968 FOF still owned approximately 40 percent of FOA's shares.

17/ There were so many entities in the IOS complex that the above text simplifies the corporate relationships involved. FOA's underwriter was IPC, and FOA's adviser was IPC's wholly-owned subsidiary, Fund of America Management Corporation.

2. Received two advisory fees out of what was in economic reality a single pool of capital -- IOS took an advisory fee from FOF in exchange for its services in putting FOF's money into FOA, and through IPC it then took a second advisory fee from FOA for managing FOA's investments. 18/

IV. THE 1966 PROCEEDING AND ITS AFTERMATH

Soon after IOS's acquisition of IPC, members of the Commission's staff reported to the Commission that information had come to their attention indicating that IOS's assertedly off-shore funds were not wholly off-shore. Our staff believed that shares in those funds had been offered and sold to an appreciable number of Americans fraudulently and in violation of the Securities Act's registration requirements. 19/ To determine whether this was actually so and what remedial action, if any, was needed, this Commission, in February 1966, instituted an administrative proceeding against IOS and some of its affiliates. 20/ After the failure of its strenuous efforts to enjoin that proceeding on the ground that we had no power to conduct it, 21/ IOS decided to settle.

During settlement negotiations with our staff, IOS learned that settlement would require a material reduction in the scope of its United States activities. IOS made an offer of settlement in which it undertook, among other things, to:

1. Divest itself of IPC within a specified time;

2. Cease selling securities to United States citizens and nationals wherever located, except, *inter alia*, for sales by IPC during its continued ownership of that entity;

3. Make a rescission offer to Americans who held interests in FOF;

4. Withdraw its own broker-dealer registration and the registrations of those of its affiliates that were then registered with us as brokers and dealers; and

5. Conduct all of its securities activities outside the United States.

18/ As we said in Public Policy: "Inherent in the fund holding company structure is a layering of costs including advisory fees, administrative expenses, sales loads, and brokerage fees, all of which serve to make a fund on funds a particularly expensive investment vehicle." Public Policy at 318.

19/ Our staff also believed that violations of the Investment Company Act had been committed.

20/ Administrative Proceeding No. 3-497 instituted by order of February 3, 1966. This proceeding is referred to as "the 1966 proceeding."

21/ *See* *Fontaine* v. *S.E.C.*, 259 F. Supp. 880 (D.P.R., 1966).

We accepted IOS's offer on May 23, 1967, thus terminating the 1966 proceeding. 22/

Before that time, IOS began to prepare for the day when it would have to dispose of IPC and place all orders for United States securities abroad through an independent foreign brokerage firm or through an independent United States brokerage firm with a foreign branch office. IOS chose Lipper as a broker for the funds managed by it. At IOS's instance, in March 1967 Lipper organized Lipper Corp., headquartered in New York, with branch offices in London and Geneva. He did so for the primary purpose of acting as a broker for the funds managed by IOS and after assurances from it of sufficient business from "IOS generated sources to cover the kind of investment involved." 23/ The "investment involved" was needed to establish an elaborate communications network for transmitting the orders that the IOS-managed funds placed with Lipper Corp.'s foreign branches to its main office in New York. Through this network those foreign funds continued to buy and sell United States securities in this country's markets rather than in those abroad.

As for IPC, the settlement agreement granted IOS a period of time before it had to sell its shares of IPC, and this was ultimately accomplished in the fall of 1968. Of course, the price that IOS could expect to obtain for its IPC shares obviously depended on the latter's earning power. IOS, therefore, had an especially strong incentive to improve IPC's performance prior to the sale. The Lipper respondents helped IOS to attain that objective.

V. REBATES OF OVER-THE-COUNTER BROKERAGE COMMISSIONS

A. The Facts and Their Legal Consequences

Lipper Corp. handled the foreign funds' over-the-counter business on an agency basis. For its services in this regard, Lipper Corp. charged the stock exchange commission rate. But it kept less than half of the resulting gross commissions. The rest of them were paid over -- "given up" in the jargon of the trade -- to IPC. These give-ups by Lipper Corp. to IPC totaled about $1,450,000 from July 1967 to August 1968. In view of IOS's relationship to IPC, that money was for all practical purposes given up to IOS.

Since neither of the IOS respondents performed any brokerage function in connection with the over-the-counter transactions handled by Lipper Corp., it is apparent that they did nothing in return for the

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22/ IOS, Ltd. (S.A.), Securities Exchange Act Release No. 8083.

23/ From April 1967 through June 1968, Lipper Corp. received gross commissions of $11,372,000, $6,014,000 of which came from IOS-related business.

income that they derived from those transactions. 24/ They simply caused the funds to divert $1,450,000 to them. Lipper Corp. was a mere conduit for the diversion. No extended discussion is required to demonstrate that this was a gross breach of fiduciary duty by the IOS respondents. 25/

Such "disregard of trust relationships by those whom the law should regard as fiduciaries" was one of the evils that the Exchange Act sought to eliminate. 26/ We therefore find, as did the administrative law judge, that the IOS respondents' over-the-counter commission-

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24/ It is true, of course, that IOS managed the funds and that this involved work. But IOS was getting a management fee for these services.

25/ Investment advisers are fiduciaries. S.E.C. v. Capital Gains Research Bureau, 375 U.S. 180, 191 (1963); Arleen W. Hughes, 27 S.E.C. 629, 635-638 (1948), aff'd sub. nom. Hughes v. S.E.C. 174 F. 2d 969 (C.A.D.C., 1949). And investment advisers to investment companies are on the same footing. Rosenfeld v. Black, 445 F. 2d 1337 (C.A. 2, 1971), petition for cert. dismissed 409 U.S. 802 (1972); Brown v. Bullock, 194 F. Supp. 207, 229 (S.D.N.Y. 1961), aff'd 294 F. 2d 415 (C.A. 2, 1961). See Provident Management Corp., 44 S.E.C. 442, 447 (1970): "Porteous and Lautsbaugh, as officers of Fund and as persons responsible for directing the execution of its portfolio transactions, and Management by virtue of its position as investment adviser, were fiduciaries of Fund. As such, they were under a duty to act solely in the best interest of Fund and its shareholders . . . . While there is no proof that Fund did not receive the best execution on its transactions, or that the existence of the arrangement described resulted in additional costs to Fund, once the reciprocal arrangements were made, it was improper for Porteous & Co. to keep for itself rather than confer on Fund the benefits attributable to Fund's assets."; Consumer-Investor Planning Corp., 43 S.E.C. 1096, 1100-1101 (1969): It is clear that [respondents] . . . placed the purchase and sale of the Fund's portfolio securities with those brokers who would pay over to them the largest extractable portions of the brokerage commissions thus generated and the most substantial other benefits. The payments and benefits received by them did not represent compensation for any services rendered to or benefits conferred upon the Fund, but rather constituted a form of personal enrichment derived from the Fund's portfolio transactions. By such blatant trafficking of the Fund's business, respondents simply used their fiduciary positions in relation to the Fund to cause monetary and other benefits to inure to themselves without regard to what was best for the Fund . . . . The abuse of position and conflict of interests inherent in the making of these arrangements was clearly inimical to the Fund and its shareholders."; Delaware Management Co., 43 S.E.C. 392 (1967).

26/ H.R. Rep. No. 1383, 73d Cong., 2d Sess. 6 (1934).

splitting arrangements were a fraud on the foreign funds and on their shareholders. 27/ It follows that the IOS respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Since the Lipper respondents knew about IOS's relationship to the foreign funds, and since their active assistance was an essential element of the scheme, they were clearly participants in the IOS respondents' breach of trust. It follows that the Lipper respondents willfully aided and abetted the IOS respondents' violations. 28/

Respondents advance various arguments, based upon then existing rules and practices in the securities markets which, they claim, justify their activities. To these we now turn.

Respondents claim that the rules of the New York Stock Exchange required the funds to bear over-the-counter brokerage costs that are conceded to have been high. They argue that:

27/ Respondents contend that their over-the-counter commission arrangements were disclosed to the directors of the foreign funds. Like the administrative law judge, we find this contention unsupported by the record. Three foreign funds were involved. The Lipper-IPC give-up arrangements are claimed to have been discussed at a meeting of one of the three boards. But what about the boards of the other two funds? No disclosures are expressly claimed to have been made to them. As to the disclosures made to the one fund, we agree with the administrative law judge that they cannot be deemed to have been adequate. But even if they had been adequate so far as the directors were concerned, it seems to us that in view of IOS's controlling influence over these entities, the disclosure required in this situation was disclosure to the shareholders actual and prospective. Moreover, the administrative law judge pointed out that the person making the purported disclosures was a principal in the scheme to defraud the foreign funds. Cf. Schoenbaum v. Firstbrook, 405 F. 2d 200, 211-212, reversed in part on other grounds en banc 405 F. 2d 215 (C.A. 2, 1968), cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906 (1969): "In general, if the corporation's agents have not been deceived, neither has the corporation. However, as in other situations governed by agency principles, knowledge of the corporation's officers and agents is not imputed to it when there is a conflict between the interests of the officers and agents and the interests of the corporate principal. [Citations omitted.] Therefore, a corporation may be defrauded in a stock transaction even when all of its directors know all of the material facts, if the conflict between the interests of one or more of the directors and the interests of the corporation prevents effective transmission of material information to the corporation, in violation of Rule 10b-5(2)." See also Pappas v. Moss, 393 F. 2d 865 (C.A. 3, 1968).

28/ See Provident Management Corp., 44 S.E.C. 442, 448 (1970).

1. As a New York Stock Exchange member, Lipper Corp. was bound to adhere to that organization's minimum commission rate schedule.

2. The anti-rebate rules that the exchange adopted for the purpose of preventing its members from cutting rates in underhanded ways precluded Lipper from returning any excess brokerage to the funds themselves.

3. There were only two choices. One was for Lipper to retain for himself all of the brokerage that the New York Stock Exchange had thrust into his unwilling hands. The other was to divide it with ICS. In no event could the funds' over-the-counter brokerage costs have been any lower than they actually were.

This argument, although perhaps superficially appealing, is, upon analysis, unavailing. The New York Stock Exchange had no jurisdiction over commission rates in over-the-counter transactions. The over-the-counter market during the relevant period was, and it still is, "a negotiated market . . . not governed by fixed prices or minimum commission rate schedules." 29/ Therefore, "any willingness of the executing broker . . . to allow his customer to direct a give-up of a portion of his commission . . . in and of itself shows that a lower . . . commission could have been negotiated." 30/

The New York Stock Exchange's anti-rebate policies are clearly not relevant here. Those policies applied only to transactions on that exchange. What they prohibited was the division of commissions paid for such transactions with those who were not themselves members of the New York Stock Exchange. 31/ The transactions involved herein were not New York Stock Exchange transactions. 32/ Nor was IPC a New York Stock

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29/ Public Policy 178. Although the practice was to charge the New York Stock Exchange minimum rate on over-the-counter transactions executed on an agency basis, no rules legally binding on Lipper required this. A violation of the National Association of Securities Dealers' Rules of Fair Practice might have been involved; however, if the commission charged was in excess of the New York Stock Exchange minimum.

30/ Public Policy 178.

31/ Public Policy 170.

32/ The New York Stock Exchange's vice president in charge of member firms testified that "The New York Stock Exchange minimum commissions applied to New York Stock Exchange trades, not over-the-counter trades." The following colloquy then ensued:

"Q To what extent does the New York Stock Exchange feel it has the authority to establish rates in the over-the counter market?

A We don't feel that we have any authority to establish rates in the over-the-counter market."

Exchange member. The Lipper respondents claim to have been in fear of disciplinary action by the New York Stock Exchange. 33/ But they have never explained why this fear did not restrain them from giving up to IPC. 34/ If the New York Stock Exchange's rules had been applicable to these transactions, they would have prohibited commission-splitting with IPC as well as with the funds that paid those commissions.

Moreover, the New York Stock Exchange had no jurisdiction over IPC. There is nothing in the record to show that the exchange would have been disconcerted had IPC returned Lipper's give-up money 35/ to the funds. 36/ Hence the administrative law judge was clearly correct when he held that:

33/ The New York Stock Exchange official previously referred to did testify that very low over-the-counter charges might in certain circumstances be deemed impermissible rebates. But he made it clear that he was talking about over-the-counter commissions that were below the cost of doing business. He further testified as follows on redirect examination by Division counsel:

"Q Now Mr. Bishop, is it a requirement of the New York Stock Exchange that the minimum New York Stock Exchange [sic] be charged by member firms in executing over-the-counter transactions, even though the minimum New York Stock Exchange commission exceeds the cost of executing the transaction?

A No."

34/ Lipper testified:

"Q Weren't you concerned that the New York Stock Exchange might consider the payment of commissions earned in the over-the-counter market, for Fund of Funds portfolio transactions, to IPC, as violative of their anti-rebate rules?

A No sir, I was not concerned."

35/ During the relevant period, the New York Stock Exchange permitted one of its members to manage a large investment company complex without receiving any management fee. The partners in that firm viewed the brokerage income that they derived from the complex's portfolio transactions as sufficient in itself to compensate them for their services. There is no indication that the Exchange considered this arrangement an impermissible rebate. See Public Policy 106-109.

36/ Whatever the New York Stock Exchange's sentiments might or might not have been, the money having come from the funds in the first place, and IPC having done nothing to earn it, there was no way in which the IOS respondents could lawfully keep it. Moses v. Burgin, 445 F.2d 369, 376 n. 11 (C.A. 1, 1971), cert. denied 404 U.S. 994 (1971).

"There was no requirement of the NYSE that its members charge NYSE rates on over-the-counter transactions and Cowett [ICS's executive vice president and the principal architect of the give-up scheme] and Lipper, both highly sophisticated in the financial world, knew or should have known the limitations of the NYSE rules. It was permissible for Lipper Corporation to charge less on the funds' over-the-counter transactions and, contrary to respondents' position, the record evidences a willingness by Lipper Corporation to be content with 50% of the amounts actually charged the funds on such transactions. In this connection, it is also clear from the record that Cowett was not interested in negotiating for a lower rate but in having Lipper Corporation give up 50% of the funds' commission payments to IPC so that the latter would obtain additional revenues."

Respondents say that customer-directed give-ups were widespread and generally regarded as legitimate in 1967 and 1968. They are right about that. But their conclusion that this justifies the activities here involved, however, is unfounded because the customer-directed give-ups referred to, which were in the exchange market, differed from the present case in two critical respects. First, they did not involve fiduciaries diverting their beneficiary's funds into their own pockets. Secondly, they represented a form of competition for lucrative institutional business that prevailed under the rigid fixed commission rate system which existed in the exchange markets only.

Exchange rules fixed minimum commissions at a rate which often exceeded the amount for which a broker was willing to execute a transaction. Exchange rules also prohibited any rebate of commissions to the customer. Under this regime, brokers sought to attract lucrative institutional business by offering various inducements to institutional customers. These included, particularly in the case of mutual funds, a willingness to give-up a portion of the commission to broker-dealers designated by the fund management, who were engaged in selling fund shares. Such give-ups represented additional compensation to these dealers for their selling activities. The exchanges chose not to regard this as a rebate. While this practice was questionable and was abolished by the exchanges in December 1968, it was permitted prior to that time as a means by which fund managers could obtain something of value for their excess commissions.

In the over-the-counter market, no fixed commission rate was imposed. The National Association of Securities Dealers, Inc., the self-regulatory body for the over-the-counter market, was and is prohibited by law from maintaining fixed commission rates. The customer-directed give-up was not prevalent in that market and was, indeed, regarded as improper, if not illegal. As the Commission noted in December 1966:

> "A directed give-up of a portion of the commission charged for handling a transaction for a fund in the over-the-counter market would be a patent waste of investment company assets." 37/

37/ Public Policy 178.

Respondents point to the fact that it was the usual practice in agency transactions in the over-the-counter market to charge the New York Stock Exchange commission rates. This appears to be correct. 38/ The conclusion which respondents derive from this, that price competition for execution services did not exist in the over-the-counter market any more than in the exchange market, does not follow. Nor does it further follow that because give-ups were accepted in exchange transactions, they were therefore also acceptable in over-the-counter transactions.

Although on small over-the-counter brokerage transactions the New York Stock Exchange commission was utilized as a familiar measure of a proper charge for the service, institutions were not required to, and usually did not, pay the high exchange commissions on large over-the-counter transactions. They simply dealt directly with over-the-counter market makers and were charged a mark-up substantially less than the applicable exchange commission. 39/ Consequently, on institutional transactions in the over-the-counter market there were no excess commissions to be disposed of by using customer-directed give-ups, and customer-directed give-ups were not utilized in that market.

Respondents argue that because the Commission's 1967 consent order precluded IOS from dealing directly with market makers, the IOS-managed funds had to pay excessive commissions and IOS had to divert the excess into its own pocket. The Commission, of course, did not intend such a result, and the order clearly does not provide for such. Nothing in the 1967 order required the funds to pay, or Lipper to charge, excessive commissions. 40/ If for any reason an institution wished to execute an over-the-counter trade with a broker-dealer firm as agent rather than as principal, this could be done, and the commission could be negotiated, as IOS and Lipper might have done here.

38/ *See* Report of Special Study of Securities Markets of the S.E.C., H.R. Doc. No. 95, pt. 2, 88th Cong., 1st Sess. 624 (1963) (hereinafter cited as Special Study).

39/ *Id.* at 627. But on the exchange, the transaction could not, of course, be executed for less than the minimum commission.

40/ Respondents appear to suggest that the practice of charging the stock exchange commission on over-the-counter transactions was not merely a practice, resorted to for convenience where appropriate, but rather reflected some type of agreement or conspiracy among broker-dealers to charge that rate under all circumstances. We can hardly assume the existence of such an agreement, particularly in view of the fact that, if practiced in the over-the-counter market where no statute affords the slightest justification for rate fixing, it would have been a flagrant violation of the antitrust laws.

Respondents claim to have relied on the advice of counsel, and they did have opinions of counsel which supported their course of conduct. Although neither ignorance of the law nor reliance upon counsel's opinions can make unlawful conduct legal, advice of counsel is often a weighty mitigating factor. 41/ This is particularly true where the law is obscure or changing, or where the issues are technical and specialized, and a layman, therefore, requires the advice of counsel in order to chart a course.

But here the situation is different. The IOS respondents sought to divert the funds' money to themselves, and the Lipper respondents knowingly participated in this effort. In doing so, they relied upon counsel's conclusion that they had discovered a loophole in the law of fiduciary responsibility. Counsel, in turn, relied upon the fact that no contested decision or rule was precisely in point and specifically prohibited respondents' scheme. This type of reliance is misplaced, particularly in the area of fraud. Moreover, counsel actually knew (not merely should have known) that this agency considered give-ups by brokers in over-the-counter transactions to be "improper and illegal." 42/ Counsel apparently disagreed with these views. That was their privilege. But both counsel and their clients were aware of the risk, and they can hardly claim that they could not reasonably foresee that the loophole which they perceived might prove to be illusory.

41/ An act done in reliance on the advice of counsel may nevertheless be "willful" within the meaning of that term as used in Section 15(b) of the Exchange Act. This is so because for purposes of that section "a violation is 'willful' whenever the actor intends to do the act that constitutes the violation without regard to whether he specifically intends to violate the law." Gearhart & Otis, Inc., 42 S.E.C. 1, 26 (1964), affirmed 348 F. 2d 798 (C.A.D.C., 1965). See also Tager v. S.E.C., 344 F. 2d 5, 8 (C.A. 2, 1965).

42/ Public Policy 185. Respondents dismiss Public Policy as a mere essay that no one was obliged to heed. One part of that report dealt with the economics and the organizational patterns of the investment company business, as it was in 1966. Since those descriptions were based on exhaustive and protracted studies, we consider them authoritative. Another part of Public Policy -- and the one pertinent here -- contained a concise and carefully considered summary of this Commission's understanding of the then existing law, the law as it already was, with respect to investment companies. A lawyer who told his clients that this was meaningless was counseling them to act at their peril. As the First Circuit said when it had to consider Public Policy's impact on Moses v. Burgin, 445 F. 2d 369, 384 (C.A. 1, 1971), cert. denied, 404 U.S. 994 (1971): "Any contention that the Commission's views were offhand or . . . inconsequential . . . is, to put it bluntly, little short of extraordinary. We may add that . . . willingness to disregard the Commission itself casts some doubt on the bona fides of a claim that the earlier expressed views of the staff were ignored because of its inferior position."

B. Jurisdictional Contentions

Respondents assert that their over-the-counter give-up arrangements are outside the Exchange Act's purview. They advance two reasons to support their contention. One is that the charges against them have no real connection with the purchase or sale of securities, but are matters involving internal corporate affairs. The other is that what is involved here is so foreign as to make the laws of the United States inapplicable.

It is true that nothing falls within the ambit of Section 10(b) of the Exchange Act or of Rule 10b-5 thereunder unless it be "in connection with the purchase or sale of any security." It necessarily follows that there is an area of internal corporate management untouched by the Exchange Act's antifraud provisions.

These generalities, however, have no bearing on the case before us. This case deals with nothing but securities transactions and the securities business. The foreign funds were investors and traders in securities. Indeed, that is all they ever did. The funds were constantly buying and selling huge blocks of securities. And they were continuously offering and selling their own shares to investors. Moreover, their shares were redeemable. Hence they were making continuing offers to repurchase their outstanding shares. In these circumstances we find it difficult to conceive of any significant aspect of their affairs that was not intimately connected with the purchase and sale of securities. We think it axiomatic that their expenditures for the brokerage services incident to such transactions were so connected.

Respondents support their contention that "foreign law rather than United States securities law is applicable" so that "the Commission is without jurisdiction or power over the allegations in this section of the order for proceedings" by pointing to Section 30(b) of the Exchange Act, which provides as follows:

> "The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title."

We note at the outset that § 30(b) does not speak of a business in securities "without the United States," but rather "without the jurisdiction of the United States." The Lipper respondents and IPC were conducting a substantial securities business in the United States. Moreover, the transactions of concern to us occurred in the United States. The Court of Appeals for the Second Circuit, in

considering the reach of Rule 10b-5, has stated that "the nation where the conduct occurred has jurisdiction to displace foreign law and to . . . apply its own." 43/

Lipper Corp. and IPC chose to register with this Commission as brokers and dealers. When they did that, they voluntarily subjected themselves and their businesses to the jurisdiction of the United States. 44/ In view of their controlling influence over Lipper Corp. and IPC, Lipper himself and IOS were also transacting a securities business within the jurisdiction of the United States. Accordingly, this Commission concludes that it has jurisdiction over the persons and the subject matter before it in this action.

C. Other Matters

The IOS respondents claim that the administrative law judge was disqualified because he reached certain conclusions and made certain findings in his initial decision dealing with the Lipper respondents before he issued his initial decision about the IOS phase of the case. He issued separate decisions to accommodate the exigencies of a situation engendered by IOS and IPC. On representations that settlement with IOS and IPC was imminent, the administrative law judge closed the record without prejudice to an application to reopen it if IOS and IPC did not settle as anticipated. When no such settlement was reached, he reopened the hearings on the issues relating to IOS and IPC. Meanwhile, he issued an initial decision dealing with the Lipper respondents. No showing of actual bias or prejudice stemming from an extrajudicial source that would warrant disqualification was made. The administrative law judge's findings against Lipper and Lipper Corp. were made in the course of his official duties. And his initial decision in the Lipper

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43/ Leasco Data Processing Equip. Corp. v. Maxwell, 468 F. 2d 1326, 1339 (C.A. 2, 1972) (Substantial conduct within the United States warrants application of Rule 10b-5 to transactions on the London Stock Exchange in securities not traded on the American markets.) In IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (C.A. 2, 1975) the Court of Appeals for the Second Circuit said: "We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners. This country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States. By the same token it is hard to believe Congress meant to prohibit the SEC from policing similar activities within this country ...." And on that same day the court underscored this in the companion case of Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (C.A. 2, 1975), where it said: "We are ... holding ... that Congress did not mean the United States to be used as a base for fraudulent securities schemes even when the victims are foreigners, at least in the context of suits by the SEC or by named foreign plaintiffs."

44/ "Jurisdiction for purposes of Section 30(b) does not mean territorial limits." S.E.C. v. United Financial Group, Inc., 474 F. 2d 354, 357-358 (C.A. 9, 1973).

case expressly pointed out that its findings were not binding on IOS and IPC. Hence he was not disqualified from subsequently deciding common legal and factual issues against IOS and IPC. 45/

VI. REBATES OF BROKERAGE COMMISSIONS DERIVED FROM NEW YORK STOCK EXCHANGE TRANSACTIONS

As previously noted, commissions on New York Stock Exchange transactions were, during the relevant period, divisible only among members of that exchange. Since neither IOS nor IPC was a New York Stock Exchange member, it would seem at first blush that there was no way in which they could derive direct pecuniary benefits from the New York Stock Exchange brokerage business placed by the IOS-managed funds. The IOS respondents, however, engaged in a scheme to obtain rebates of brokerage commissions paid on New York Stock Exchange transactions. 46/

The New York Stock Exchange commissions here under attack were paid by IPC's domestic fund, FOA, an investment company registered with us as such under the Investment Company Act.

The salient facts are these:

1. The IOS respondents gave some of FOA's New York Stock Exchange brokerage business to X Company, a New York Stock Exchange member firm. They did so because X Company had devised a technique for transmitting substantial chunks of excess institutional New York Stock Exchange brokerage back to the managers who placed orders with it.

2. X Company did not share the institutional New York Stock Exchange commission payments themselves with non-members. That would have been a blatant and an easily-detected violation of the New York Stock Exchange's anti-rebate rules. X Company's modus operandi involved the splitting of commissions generated by transactions in the over-the-counter market and on the Boston Stock Exchange. 47/ The institutional manager

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45/ Transamerica Corporation, 10 S.E.C. 454, 473-474 (1941); Kennedy, Cabot & Co., Inc., 44 S.E.C. 216, 223 (1970). Cf. Federal Trade Commission v. Cement Institute, 333 U.S. 683, 702-703 (1948); United States v. Grinnell Corp., 384 U.S. 563, 582-583 (1966); Lyons v. United States, 325 F.2d 370, 375-376 (C.A. 9, 1963).

46/ The Lipper respondents have no connection with this aspect of the proceedings.

47/ X Company was a member of both the Boston and the New York Stock Exchanges. Like most other regional exchanges, the Boston Stock Exchange permitted its members to divide commissions with other professionals in the securities business, whether or not they belonged to it or any other exchange. See Public Policy 171; Moses v. Burgin, 445 F. 2d 369, 375-376 (C.A. 1, 1971) cert. denied 404 U.S. 994 (1971).

with whom those commissions were divided had no connection with, and had never even heard of, the over-the-counter and Boston transactions in question. X Company's clients in these trades were generally not institutions. Yet X Company was ready, willing, and able to send a stream of money arising out of these transactions to any institutional manager who placed New York Stock Exchange business with it.

3. The amount of money that the institutional manager could expect to receive from X Company was directly related to the amount of New York Stock Exchange business he gave it. Thus, for example, an FOA New York Stock Exchange trade that produced a $5,000 commission for X Company would be followed by a $2,500 check from it to IPC.

4. X Company, however, was not a large firm. Neither its over-the-counter nor its Boston volume was large enough to create a give-up pool sufficient in size to satisfy the IOS respondents' desire for commission money.

5. At this point, Y Company, another brokerage house, became involved. Y Company was not a New York Stock Exchange member. But it had developed an ingenious "new technique" for arranging give-ups. The key to the new technique was Y Company's membership on the American Stock Exchange. Now the simple two-sided arrangement of old was displaced by a triangular relationship among IPC, X, and Y, involving:

(a) The continued placement of FOA's New York Stock Exchange business with X Company -- accompanied now, however, by the notation that the order had been placed with X Company, "courtesy of Y Company";

(b) X Company's placement with Y Company of enough American Stock Exchange business to produce net commissions for Y Company equal to the amount of the New York Stock Exchange commissions just paid by FOA to X Company;

(c) Y Company's subsequent disbursement of 52 percent of the commissions received from the American Stock Exchange business that X Company had forwarded to it to two of Y Company's registered representatives;

(d) The retention by those registered representatives of two percent of the aforementioned commissions to compensate them for their services as intermediaries; and

(e) The transmission of the 50 percent of these commissions to IPC so that the upshot of this series of maneuvers was the return to IPC of 50 percent of the commissions its cestui que trust, FOA, had paid X Company.

Since IOS and IPC were fiduciaries for the funds they controlled, neither of them was free to appropriate benefits derived from the execution of FOA's portfolio transactions for itself. 48/ Of course, an investment company's manager may also be its broker. 49/ When the manager acts as a broker, he is entitled to be paid for his work. 50/ Here, however, neither IOS nor IPC ever supplied any brokerage services to FOA. Hence this is a twice-told tale. In the New York Stock Exchange context with FOA's commissions, just as in the over-the-counter context with the foreign funds' commissions, the IOS respondents used their strategic position in, and controlling influence over, the funds to collect brokerage income from them without supplying any brokerage services in return.

We find, as did the administrative law judge, that the IOS respondents' activities in connection with FOA's New York Stock Exchange transactions were in willful violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. We affirm and adopt as our own his holding that:

> "No legal impediment precluded FOA instead of IPC from being the beneficiary of the arrangements . . . . [T]he arrangements . . . constituted a fraud upon FOA and its shareholders for which IPC, and IOS as a participant in the scheme, must be held accountable. It is also manifest from the record that IOS and IPC withheld details regarding arrangements that had been made for the benefit of IPC from FOA and its shareholders. Full and complete disclosure of that information was required of IOS and IPC in order to meet the fiduciary responsibilities that they had assumed by their active intervention in the management of FOA. The failure of the respondents in this regard can only be viewed as deliberate, and a deception that respondents felt necessary to the success of their scheme."

The IOS respondents argue that their conduct was justifiable under then existing industry practices and the New York Stock Exchange's rules. They claim that:

48/ See Provident Management Corp., 44 S.E.C. 442 (1970); Consumer-Investor Planning Corp., 43 S.E.C. 1096 (1969).

49/ See Public Policy 71, 188-190.

50/ Section 17(e)(2)(A) of the Investment Company Act permits persons affiliated with registered investment companies and persons affiliated with such persons to receive "the usual and customary broker's commission if the sale is effected on a securities exchange."

1. New York Stock Exchange anti-rebate rules made it impossible for FOA to benefit from the reciprocal payments.

2. Retail sellers of investment company shares commonly received reciprocal income from the funds' portfolio brokerage transactions.

3. The reciprocal income paid IPC, and through it to IOS, was simply additional compensation for IPC's services as the principal retail distributor of FOA's shares.

4. Both IPC and FOA would have been at a competitive disadvantage vis-a-vis other mutual funds and other mutual fund managers, had they been precluded from paying and receiving reciprocal income.

These contentions are without merit.

We begin by assuming arguendo that what respondents say about the impact of the New York Stock Exchange's anti-rebate rules is correct. On that assumption, no direct pecuniary benefits could have been passed back to FOA. Hence the IOS respondents had to choose between letting New York Stock Exchange members keep all of the commissions or devising some plan by which they, the respondents, could share in them.

Even if that had been the situation, respondents would not have been privileged to do as they did. True, direct price competition among exchange members was suppressed. But it does not follow that there was no competition at all among exchange members. The sellers of New York Stock Exchange brokerage services were, in fact, in vigorous non-price competition with each other. In the institutional sphere, that non-price competition took several forms. One most significant form was a competition in supplying services to the institutions. Investment research was the principal form of such service. 51/

In the circumstances of this case, the IOS respondents were under a duty to deploy FOA's excess brokerage or "brokerage power" for the fund's benefit, not theirs. It follows that, if they had the capacity to cause any part of the commissions to leave the hands of the executing broker, they were bound to use that part to buy research and related services of value to FOA's shareholders. When respondents entered into their kickback arrangements with X and Y, they breached that duty. Those arrangements were of great benefit to respondents. But they did nothing at all for FOA. To the extent respondents chose to induce the

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51/ See Public Policy 163-164.

executing broker to give up a portion of the commissions, they could not cause it to benefit themselves in preference to FOA. 52/

The rules of the New York Stock Exchange provide no more justification for the IOS respondents' retention of a portion of the commissions on the New York Stock Exchange transactions than they did on the over-the-counter transactions previously discussed. IOS and IPC were neither members of the New York Stock Exchange nor subject to its rules. And even if they had been, nothing in those rules would have compelled them to keep this give-up money for themselves. These are what we deem the controlling considerations:

> 1. Complex reciprocal and give-up arrangements, such as those that were entered into here, were designed for the very purpose of avoiding the New York Stock Exchange's anti-rebate rules. The over-the-counter markets and the regional exchanges were brought into the picture because the New York Stock Exchange had no more than the most peripheral sort of control, if that, over the economic aspects of its members' activities on those markets. 53/

52/ The peculiarities of the investment company context call for standards higher, not lower, than those that prevail elsewhere. Cf. Brown v. Bullock, 194 F. Supp. 207, 233 (S.D.N.Y., 1961), affirmed 294 F.2d 415 (C.A. 2, 1961): "In light of the distinctive character of investment companies and their easy susceptibility to management abuses (e.g., looting of the companies by insiders using means both crude and subtle), one of the primary objectives of the 1940 Act was the protection of investment companies as well as investors against the derelictions of investment companies' directors, investment advisers, other fiduciaries, and principal underwriters."

53/ As the 1963 Special Study pointed out: "Return by an NYSE member of cash to his reciprocal correspondent for commission business would violate the anti-rebate rule . . . , but the return of a cash equivalent in the form of profitable security commission business which might have been transacted directly by the NYSE member is permissible . . . . The Exchange's published constitution and rules have never officially recognized a need to regulate reciprocal commission arrangements. Its rule 369 outlaws 10 specific commission practices either outright or under specified conditions, but does not mention reciprocal arrangements with non-member professionals." H.R. Doc. No. 95, pt. 2, 88th Cong., 1st Sess. 304.

2. The New York Stock Exchange did not object to arrangements under which excess brokerage stemming from transactions on its floor was used to reduce an investment company's advisory fee. Hence it would have been quite easy to give FOA the benefit of these give-ups. But respondents had no desire to do that.

3. Unlike the New York Stock Exchange, six of the seven regional exchanges permitted non-members who were professionals in the securities business to share in commissions arising out of transactions executed on them. 54/.

Respondents' argument that the give-ups in question are analogous to those that were common in the investment company industry during the relevant period is misplaced. As the owner of FOA's investment adviser and manager and as the principal underwriter of FOA's shares, IPC's position was in no way comparable to that of a mere retail seller of fund shares to whom the adviser-underwriters of the various funds whose shares he sold directed reciprocal brokerage income by way of give-ups in order to provide an additional incentive to sell their shares. IPC was a fiduciary for FOA and its shareholders. The ordinary retail dealer is a merchant of mutual fund shares; no fiduciary relationship exists between him and his merchandise.

A mutual fund's adviser-underwriter needs no special incentive to promote the sale of shares in his own funds. His advisory fee supplies him with sufficient motive. And unlike the independent retail dealer, the adviser-underwriter has the entire sales charge at his disposal. Moreover, he has voluntarily bound himself by contract to exert his best efforts to promote the sale of the fund's shares.

54/ Public Policy 171-173.. "It would not be inconsistent with those rules for dealer-distributed funds to direct give-ups to their adviser-underwriters, all of whom are NASD members, for the purpose of applying these give-ups to reduce the advisory fees payable by the funds." Id. at 173. See also Moses v. Burgin, 445 F. 2d 369, 375 (C.A. 1, 1971), cert. denied 404 U.S. 994 (1971).

To the independent retail dealer, on the other hand, the hundreds of mutual funds promoted and managed by the various competing adviser-underwriters present a wide choice. Within a broad area, he has no special reason to prefer to sell the shares of Fund Complex A rather than Fund Complex B. Hence the adviser-underwriters who sold through retail dealers were under strong competitive pressure to reward those dealers with give-up money. 55/ The sale of FOA shares was already attractive to the IOS respondents. There was no need to make it even more attractive. 56/ We think it clear that the give-ups in question were not engendered by competitive exigencies. 57/

The IOS respondents assert that the FOA brokerage arrangements were adequately disclosed in its prospectuses. We see no substance to this disclosure claim. 58/ We are in full accord with the administrative judge's holding that FOA's prospectuses were inadequate and misleading.

The prospectuses made various statements about brokerage and about the basis on which brokers were selected. Those statements were more or less standard in the mutual fund prospectuses of those days. Although they could have been sharpened to some extent, they did say that FOA might give its brokerage business to those who sold its shares. They also said that brokerage might be allocated "at the request of dealers including the Principal Distributor."

55/ Public Policy 170: "The customer-directed give-up has been used extensively by the funds. It permits them to entrust the execution of their portfolio transactions to a selected few brokers in whom they have special confidence and to reward with substantial cash payments the far larger group of brokers that distribute their shares."

56/ A high IOS official testified: "I very strongly urged [that] the firm 'profitability-wise' [would realize] much more residual benefits for the years to come through the building of a management fee than selling other people's funds even at maximum commission rates. I wasn't alone . . . . [E]verybody recognized that."

57/ Respondents' counsel treat the distinction between the adviser-underwriter who directed give-ups to unaffiliated retail dealers and their clients who directed give-ups to themselves as a distinction without a difference. We disagree. We see a very real difference between the two situations. It is true that the adviser-underwriters who scattered give-up largesse among hosts of retail dealers did so out of self-interest. By treating those dealers generously, the adviser-underwriter encouraged sales, thereby enhancing the size of the fund and his management fee. But IPC did not rely to any appreciable extent on independent dealers. It had its own sales force. And as a fiduciary, it could not retain any part of the give-ups.

58/ Respondents say that they were not responsible for FOA's prospectuses. In view of their control over every aspect of FOA's affairs and of the fact that the FOA prospectus was on at least one occasion amended to accommodate them, we must reject their claim.

These "disclosures" certainly did not inform the ordinary investor that respondents were deriving direct cash benefits from FOA's brokerage without doing any work in exchange for those benefits. A prospectus must be clear and candid. 59/ And FOA's prospectuses were at best murky and ambiguous. In their last brief to us, IOS respondents themselves concede that "in hindsight" the "disclosures may appear . . . overly cryptic." 60/

Respondents state that IPC collected $297,422 from X Company and Y Company as its share of FOA's New York Stock Exchange portfolio brokerage commissions. IPC ultimately returned this money to FOA. But it did not do so until after our staff had raised questions about the matter and had made it plain that it considered restitution the appropriate course. A refund made under such circumstances is no defense to the violations charged. And its mitigative weight is minimal. 61/

59/ See, e.g., Franchard Corp., 42 S.E.C. 163, 184 (1964) and cases there cited. See also The Wolf Corp., 42 S.E.C. 1042, 1049 (1966): "The Act required a clear and uncomplicated statement in the prospectus of the basic facts."

60/ Respondents argue that the disclosures in the prospectuses must have been adequate because our staff "cleared" them. There is no substance to that argument. To begin with, there is nothing in the record that even suggests that our staff knew that the prospectuses were supposed to disclose that the IOS respondents were taking FOA's excess brokerage. Secondly, "The burden of seeing to it that a registration statement filed with us neither includes any untrue statement of a material fact nor omits to state any material fact required to be stated therein or necessary to make the facts therein not misleading always rests on the registrant itself, and it never shifts to our staff." Doman Helicopters, Inc., 41 S.E.C. 431, 441 (1963). Thirdly, there can be no such thing as an estoppel against the Government in circumstances such as these. Boruski v. S.E.C., 289 F. 2d 738, 740 (C.A. 2, 1961); S.E.C. v. Culpepper, 270 F. 2d 241, 248 (C.A. 2, 1959); S.E.C. v. Morgan, Lewis & Bockius, 209 F. 2d 44, 49 (C.A. 3, 1953).

61/ As we said in Richard K. Fudge, 30 S.E.C. 334, 339 (1949): "While restitution to defrauded persons is to be encouraged, we cannot, on that basis alone, permit violators to escape the consequences of their acts, particularly when restitution comes after discovery of their misdeeds." The significance of the refund to FOA is further diminished by the fact that no part of the far larger sums ($1,450,000 as against $297,422) derived from the foreign funds' over-the-counter brokerage commissions was ever returned to those entities.

The above-described conduct with respect to FOA constituted a willful violation by IPC, willfully aided and abetted by IOS, of Section 17(e)(1) of the Investment Company Act. 62/ As pertinent here, that section makes it unlawful for any affiliated person of a registered investment company, or any affiliated person of such person, "acting as agent, to accept from any source any compensation . . . for the purchase or sale of any property to or for such registered company . . . except in the course of such person's business as an underwriter or broker." IOS and IPC were affiliated persons of an affiliated person of FOA. And they also had the power to make FOA's investment decisions and to direct its portfolio transactions. Accordingly, they were "acting as agent" within the meaning of Section 17(e)(1). 63/ Neither of them ever performed any brokerage or underwriting services in connection with the purchase and sale of FOA's portfolio securities. Those securities were FOA's "property" within the meaning of Section 17(e)(1). 64/ Accordingly, the retention of the reciprocal benefits derived from FOA's portfolio transactions was an impermissible form of compensation proscribed by Section 17(e)(1). As affiliated persons who were not acting as brokers for FOA, IOS and IPC were subject to the prohibitions of Section 17(e)(1). 65/

62/ As we have seen, unlike the foreign funds, FOA was a registered investment company.

63/ Cf. United States v. Deutsch, 451 F. 2d 98, 109-111 (C.A. 2, 1971) cert. denied, 404 U.S. 1019 (1972).

64/ Id. at 114. See also Provident Management Corp., 44 S.E.C. 442, 448 (1970); Consumer-Investor Planning Corp., 43 S.E.C. 1096, 1101 (1969).

65/ As the Court of Appeals for the Second Circuit held in United States v. Deutsch: " '[A]cting as agent' is . . . a descriptive phrase distinguishing affiliated persons acting as brokers from those who are not acting as brokers in connection with a sale or purchase of securities for an investment company." 451 F. 2d at 111. As one commentator observes: "Section 17(e) is basically an anti-kickback provision. Its proscriptions apply when the affiliated person (or an affiliated person thereof) acts as an 'agent'; when the money received constitutes 'compensation'; and the activities giving rise to the compensation are not within 'the course' of the affiliated person's 'business as an underwriter or broker'." Butowsky, Mutual Fund Brokerage, 3 Rev. of Securities Regulation 915 (1970).

Violations of other sections of the Investment Company Act flow from the findings of violations of the antifraud provisions and the provisions of Section 17(e)(1). Thus, FOA's advisory contract failed to disclose, as required, that its manager's compensation would include payments to IPC attributable to the allocation of brokerage on FOA portfolio transactions. The proxy solicitation material used in connection with the March 1967 FOA stockholders' meeting and filed with us, and the April 1967 prospectus of FOA also filed with us, failed adequately to disclose that IPC would derive reciprocal income from the allocation of brokerage at its request and the inherent conflicts of interest detrimental to FOA. Under the circumstances, we conclude that IOS and IPC, which controlled FOA, willfully violated or willfully aided and abetted violations of Sections 15(a)(1), 20(a) and 34(b) of the Investment Company Act and Rule 20a-1 thereunder. 66/ Those respondents also willfully aided and abetted violations of Section 31(a) of the Investment Company Act and Rule 31a-1(b)(9) thereunder, in that through the concealment of such information, they caused FOA to maintain records which did not accurately reflect, as required, the basis for allocating its portfolio orders and the division of compensation on such orders.

VII. THE PUBLIC INTEREST

A. IOS

IOS is a shambles today. There is little reason to believe that it has any appreciable power to inflict further harm on investors. Nevertheless, we agree with the administrative judge that it is in the public interest to bar IOS from association with any broker or dealer. 67/ That conclusion rests on two grounds.

The first relates to the gravity of IOS's willful violations. When misconduct is as serious and as pervasive as that of IOS in this case, we think the burden is on the respondent to show us why something

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66/ Section 15(a)(1) prohibits a person from serving as an investment adviser of a registered investment company in the absence of a written contract precisely describing all compensation to be paid thereunder. Section 20(a) and Rule 20a-1 prohibit solicitations of proxies by means of a proxy statement containing any false or misleading statement of a material fact. Section 34(b) contains a similar prohibition with respect to documents filed or transmitted pursuant to provisions of the Investment Company Act.

67/ See Globe Aircraft Corp., 26 S.E.C. 43 (1947) where we issued a stop-order suspending the effectiveness of a Securities Act registration statement even though the issuer had been adjudicated a bankrupt so that the possibility of future trading in the registered securities was extremely remote. We did so because we considered a "stop-order . . . a necessary corollary of our finding that the registration statement is false and misleading" and because we viewed such an order as the appropriate "means of formally terminating the effectiveness of the misleading document." 26 S.E.C. at 55.

less than a total bar would be appropriate. No such showing having been made, anything short of a total bar would be inappropriate. 68/

Secondly, we must weigh the effect of our action or inaction on the welfare of investors as a class and on standards of conduct in the securities business generally. If these proceedings are to be truly remedial, they must have a deterrent effect on other investment company managers who may be tempted to enrich themselves at the expense of their beneficiaries. 69/ We think that a total bar is necessary to provide the deterrent effect.

B. IPC

IPC's case differs materially from IOS's. IPC was a mere instrumentality. It was never an independent actor. Moreover, its present owners are wholly unaffiliated with IOS. It follows that a sanction against IPC could not possibly tend to achieve any remedial purpose. We therefore find it in the public interest to discontinue the proceedings, so far as they relate to IPC.

C. Lipper Respondents

In his initial decision the administrative law judge said that the Lipper respondents' violations "were serious and long continuing." He also found that:

> "Lipper . . . did nothing to ameliorate [the] fraudulent practice until his own . . . financial success [was] assured. The picture that emerges from the record is of a man intent on personal gain and willing to take the risk that the scheme by which he could reach his goal would not be found illegal."

In spite of these considerations, the administrative law judge thought twelve-month suspensions appropriate. He saw no likelihood that the Lipper respondents' misconduct would be repeated. And he viewed the unfavorable publicity that they had already received because of the institution of these proceedings as being in itself a sanction of some severity.

68/ Our 1967 order requiring IOS to conduct all its securities activities outside the United States does not warrant a different result. That order was in the nature of a resignation by IOS as a part of a settlement of charges based on entirely different facts. It can neither be equated with nor viewed as a substitute for a bar order predicated on findings of fact such as those made in this opinion.

69/ Beck v. S.E.C., 430 F. 2d 673 (C.A. 6, 1970) is inconsistent with these views. But we respectfully disagree with the holding of that case and decline to follow it.

The administrative judge is an adjudicator of long experience and great acumen. Hence we have considered his views with special care. We are, nevertheless, constrained to reject them. As we see it, the Lipper respondents were as culpable as IOS. In situations of this sort, the remitting broker and the receiving institutional manager are acting in pari delicto. Neither can accomplish his ends without the other. We cannot be as sanguine as the administrative law judge about future derelictions of this sort by the Lipper respondents. What we have before us is not some isolated indiscretion. Lipper Corp. owed its existence to IOS. And the Lipper-IOS relationship was rooted in the over-the-counter give-ups that flowed from Lipper to IPC.

Congress, in writing Section 15(b) of the Exchange Act, viewed past misconduct as the basis for an inference that the risk of probable future misconduct was sufficient to require exclusion from the securities business. Having been directed by the Act to draw that inference whenever our discretion leads us to consider it appropriate, 70/ we must do so if the legislative aim is to be attained. 71/ We think the likelihood of future misconduct by the Lipper respondents sufficient to call for their exclusion from the securities business. 72/ Moreover, as we have indicated in discussing IOS, that sanction will have a deterrent effect on other broker-dealers who may be inclined to participate in the fraudulent schemes concocted by investment company managers.

70/ See A. J. White & Co., Securities Exchange Act Release No. 10645, pp. 5-6 (February 15, 1974), 3 SEC Docket 550, 551-552; Foelber-Patterson, Inc., 12 S.E.C. 330, 336 (1942).

71/ In the securities business opportunities for dishonesty recur constantly. This necessitates specialized legal treatment. See Archer v. S.E.C., 133 F. 2d 795, 803 (C.A. 8, 1943), cert. denied 319 U.S. 767 (1943); Hughes v. S.E.C., 174 F. 2d 969, 975 (C.A.D.C., 1949).

72/ This is so even though it appears that some years have now elapsed since they were last engaged in the securities business. That obviated any need for speedy action by us. However, the Lipper respondents are still legally free to engage in the securities business. Since we believe that this would be incompatible with the public interest, we are constrained to take appropriate preventive action.

VIII. CONCLUSION

Our order will:

1. Bar IOS from association with any broker or dealer;
2. Discontinue the proceedings with respect to IPC;
3. Revoke Lipper Corp.'s broker-dealer registration; 73/ and
4. Bar Arthur Lipper, III from association with any broker or dealer. 74/

By the Commission (Chairman GARRETT, Commissioners LOOMIS, EVANS and SOMMER), Commissioner POLLACK not participating.

George A. Fitzsimmons
Secretary

73/ Lipper Corp. has applied for the withdrawal of that registration. Since we find revocation the appropriate course, we shall deny that request.

74/ The exceptions to the initial decision are overruled or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 11773 /October 24, 1975

Admin. Proc. File Nos.
3-2156 and 3-2157

In the Matters of ARTHUR LIPPER CORPORATION 140 Broadway New York, New York (8-13182) ARTHUR LIPPER, III IOS, LTD. (S.A.) Geneva Switzerland INVESTORS PLANNING CORPORATION OF AMERICA (now known as CIP, Inc.) New York, New York (8-12374)	:

ORDER IMPOSING REMEDIAL SANCTIONS AND DISCONTINUING PROCEEDINGS

On the basis of the Commission's opinion issued this day, it is

ORDERED that IOS, Ltd. (S.A.) be, and it hereby is, barred from association with any broker or dealer; and it is further

ORDERED that Arthur Lipper Corporation's request for the withdrawal of its registration as a broker and dealer be, and it hereby is, denied; and it is further

ORDERED that Arthur Lipper Corporation's aforementioned broker-dealer registration be, and it hereby is, revoked; and it is further

ORDERED that Arthur Lipper, III be, and he hereby is, barred from association with any broker or dealer; and it is further

ORDERED that the proceedings with respect to Investors Planning Corporation of America, now known as CIP, Inc., be, and they hereby are, discontinued.

By the Commission.

George A. Fitzsimmons
Secretary

3-2156-1
R/A
3906

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 11980 / January 6, 1976

SECURITIES & EXCHANGE COMM
MAILED FOR SERVICE
JAN 9 1976
CTFD. NO. 804863 thru 804870

Admin. Proc. File Nos. 3-2156 and 3-2157

In the Matter of

ARTHUR LIPPER CORPORATION, ET AL.
140 Broadway
New York, New York
(8-13182)

MEMORANDUM OPINION AND ORDER DENYING PETITION FOR REHEARING

PRACTICE AND PROCEDURE

Rehearing

Oral Argument

Petition for rehearing based solely on changes in the Commission's composition between the date of oral argument and the date of decision, so that three of the four commissioners who participated in the decision had not been present at the argument, denied, because petitioners' position that a reading of the transcript of the argument was an inadequate substitute for the live argument greatly overstated the importance of the latter and because rehearing was unlikely to alter the result.

APPEARANCES:

John A. Dudley and Judith E. Minsker, of Sullivan & Worcester, for Arthur Lipper Corporation and Arthur Lipper, III.

Theodore I. Sonde, Gregory C. Glynn, William D. Moran and Marvin E. Jacob, for the Commission's Division of Enforcement.

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I.

Between the date on which oral argument was heard and the date on which the cause was decided, the composition of this body changed. Three of the four commissioners who participated in the unanimous decision (Securities Exchange Act Release No. 11773 (October 24, 1975), 8 SEC Docket 273) did not take their seats here until after argument had been heard by their predecessors. Pointing to that fact and to it alone, respondents seek rehearing.

II.

Respondents state that they are "fully aware" of Rule 21(f) of our Rules of Practice, which provides that "Any member or members of the Commission who were not present at the oral argument may participate in the decision of the proceeding. Any Commissioner participating in the decision who was not present at oral argument will review the transcript of such argument." They contend, however, that this rule applies only to cases in which "a majority of the quorum participating in the decision had in fact heard oral argument." They argue that:

456

"The passive reading of a transcript is not equivalent to active, in person, oral advocacy. A procedure whereby oral argument presented to one group of Commissioners is put in written form and read by another group, in effect robbed the petitioners of an opportunity to present their case orally."

III.

We disagree. Respondents cite no authority in support of their position. Nor has our own research unearthed anything that tends to sustain the conclusory contention that the "circumstances of this case demand that oral argument be reheard to effect substantial due process." 1/

IV.

We do not deprecate the value of live argument. But we think that applicants exaggerate its significance. 2/ It is true that an adjudicator who actually listens to oral advocacy is in a somewhat different position from one who reads the transcript of an oral argument made to others. That difference, however, is one of degree, not one of kind. It is not fundamental enough to raise a due process question.

The transcript of an oral argument on legal questions preserves everything of substance that transpired when the advocates spoke. True, a transcript cannot perpetuate gesture, demeanor, tone of voice. But these, whatever their significance in jury trials on questions of fact, are of no real moment here.

V.

The instant application raises only a procedural question of a discretionary character. No showing has been made that warrants exercising that discretion in respondents' favor. 3/ When the case was here, it was considered with great care. The opinion was based on a careful study of the massive record and of the materials cited by the parties as well as those found by our own research. Respondents raise no new points. Nor

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1/ What are those circumstances? Respondents point to two. They say that "Important legal issues are in controversy" and that "the Commission's action against the Petitioners has severely limited their business activities." But there is nothing the least unusual about either factor. We often deal with important legal issues. And the very nature of our quasi-judicial duties frequently demands the imposition of severe limitations on the business activities of the respondents who come before us.

2/ See Morgan v. United States, 298 U.S. 468, 481 (1936); Federal Communications Commission v. WJR, 337 U.S. 265, 281-284 (1949); Gearhart & Otis, Inc., 42 S.E.C. 1 (1964); Isthmus Steamship & Salvage Co., 42 S.E.C. 465 (1964).

3/ The changes in the composition of this body on which the instant application is predicated took place long before the decision issued. Respondents could have moved for reargument while the case was still undecided. But they did not choose to do so.

do they try to show us how we erred. Hence we think it most unlikely that rehearing would alter the result. In these circumstances a new round of oral argument appears pointless. 4/

VI.

Accordingly, the petition for rehearing is DENIED.

By the Commission (Commissioners LOOMIS, EVANS and SOMMER); Chairman HILLS and Commissioner POLLACK not participating.

George A. Fitzsimmons
Secretary

458

4/ Compare Christiana Securities Company, Investment Company Act Release No. 8692 (February 27, 1975), 7 SEC Docket 369.